



UNIVERSITY OF  
LIVERPOOL

**STATE-OWNED ENTERPRISES AND THE  
INTERNATIONAL INVESTMENT LAW REGIME**

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By

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## ABSTRACT

The international investment law regime has been undergoing significant changes in recent years due to the substantial rise of foreign investments made by state-owned enterprises (SOEs) and the consequential regulatory responses taken by some major host states. In this context, this thesis attempts to examine whether and to what extent the international investment law regime has evolved to adequately respond to the changing realities in international investment, especially the rise of SOEs as a new type of investor.

This thesis, therefore, provides a novel and systematic review of the important issues relating to SOE investments, including the qualification of SOEs for investment protections, the admission of foreign SOEs, substantive standards of SOE protections such as non-discriminatory treatment and fair and equitable treatment, and exceptions that justify host states' measures against SOEs. This thesis argues that new generation investment treaties have struck a balance of rights and obligations between SOE investors and host states, namely, providing investment protections for SOEs whilst preserving host states' regulatory rights to pursue national interests and public policy objectives, and at the same time, addressing investment promotion and liberalisation. Furthermore, the emergence of measures tailored to regulate SOE investments indicates that an 'East-West' contest has emerged in recent investment regimes, complicating the current major tension of the 'Public-Private' debate and producing more divergence in states' investment policies at both national and international levels.

This thesis suggests that it is neither proper nor sensible for the international investment law regime to restrict or exclude SOE investments merely on the basis of state ownership. Further clarifications and recalibrations of investment protections will be helpful to strike a better balance of interests between investors and states and to minimise potential risks in international investment arbitration. It is hoped that this thesis contributes to the SOE investment commentary and provides some useful insights into the evolving international investment law as well as recommendations for a balanced, non-discriminatory and liberal future investment law regime.



To my parents and grandparents.



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## **LIST OF ABBREVIATIONS**

|        |   |
|--------|---|
| ASEAN  | Association of Southeast Asian Nations                |
| BIT    | Bilateral Investment Treaty                           |
| BLEU   | Belgium-Luxembourg Economic Union                     |
| BMMC   | British Monopolies and Mergers Commission             |
| CC     | Competitive Commission                                |
| CCP    | Chinese Communist Party                               |
| CETA   | EU-Canada Comprehensive Economic and Trade Agreement  |
| CFIUS  | Committee on Foreign Investment in the United States  |
| CFTA   | African Continental Free Trade Area                   |
| CMS    | Competition and Markets Authority                     |
| CN     | Competitive Neutrality                                |
| CNOOC  | China National Offshore Oil Corporation               |
| CNPC   | China National Petroleum Corporation                  |
| COMESA | Common Market for Eastern and Southern Africa         |
| CP     | Canada Post   |
| CSR    | Corporate Social Responsibility                       |
| ECHR   | European Court of Human Rights                        |
| ECJ    | European Court of Justice                             |
| ECT    | Energy Charter Treaty                                 |
| EFTA   | European Free Trade Association                       |
| EU     | European Union  |
| EUMR   | EU Merger Regulation                                  |
| FDFA   | Swiss Federal Department of Foreign Affairs           |
| FDI    | Foreign Direct Investment                             |
| FET    | Fair and Equitable Treatment                          |
| FIBR   | Foreign Investment Review Board                       |
| FIE    | Foreign-Invested Enterprise                           |
| FINSA  | Foreign Investment and National Security Act          |
| FIPA   | Foreign Investment Promotion and Protection Agreement |
| FSIA   | Foreign Sovereign Immunities Act                      |
| FTA    | Free Trade Agreement                                  |

|        |  |
|--------|--|
| FTAAP  | Free Trade Area of the Asia-Pacific  |
| FTC    | Free Trade Commission  |
| FTZ    | Free Trade Zone  |
| G20    | Group of Twenty  |
| GATS   | General Agreement on Trade in Services                                       |
| GATT   | General Agreement on Tariffs and Trade                                       |
| GNI    | Gross National Income  |
| IBRD   | International Bank for Reconstruction and Development                        |
| ICA    | Investment Canada Act  |
| ICS    | Investment Court System  |
| ICSID  | International Centre for Settlement of Investment Dispute                    |
| ICTSD  | International Centre for Trade and Sustainable Development                   |
| IIA    | International Investment Agreement   |
| ILC    | International Law Commission   |
| ISDS   | Investor-State Dispute Settlement  |
| KFAE   | Kuwait Fund for Arab Economic Development                                    |
| KIA    | Kuwait Investment Authority  |
| KIO    | Kuwait Investment Office   |
| M&A    | Merger and Acquisition   |
| MAI    | Multilateral Agreement on Investment   |
| MFN    | Most-Favored-Nation Treatment  |
| MNE    | Multinational Enterprise   |
| MOFCOM | Ministry of Commerce of the People's Republic of China                       |
| NAFTA  | North American Free Trade Agreement  |
| NDRC   | National Development and Reform Commission of the People's Republic of China |
| NDT    | Nondiscriminatory Treatment  |
| NIEO   | New International Economic Order   |
| NPM    | Non-Precluded Measure  |
| NT     | National Treatment   |
| OECD   | Organisation for Economic Cooperation and Development                        |
| OFT    | Office of Fair Trading   |
| OPEC   | Organisation of the Petroleum Exporting Countries                            |

|          |   |
|----------|---|
| PAP      | Publications Assistance Program   |
| PCA      | Permanent Court of Arbitration  |
| PRC      | People's Republic of China  |
| RCEP     | Regional Comprehensive Economic Partnership                                       |
| SAFE     | Chinese State Administration of Foreign Exchange                                  |
| SASAC    | State-owned Assets Supervision and Administration Commission of the State Council |
| SOE      | State-Owned Enterprise  |
| SO-MNE   | State-Owned Multinational Enterprise  |
| SWE      | Sovereign Wealth Enterprise   |
| SWF      | Sovereign Wealth Fund   |
| TIP      | Treaties with Investment Provision  |
| TISA     | Trade in Services Agreement   |
| TPP      | Trans-Pacific Partnership   |
| TRIMs    | Agreement on Trade-Related Investment Measures                                    |
| TTIP     | Transatlantic Trade and Investment Partnership                                    |
| UAE      | United Arab Emirates  |
| UNCITRAL | United Nations Commission on International Trade Law                              |
| UNCTAD   | United Nations Conference on Trade and Development                                |
| US       | United States   |
| USCBC    | US China Business Council   |
| VCLT     | Vienna Convention on the Law of Treaties  |
| WIR      | World Investment Report   |
| WTO      | World Trade Organization  |





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## CHAPTER 1:

# SOES AND THE INTERNATIONAL INVESTMENT LAW IN A CHANGING WORLD

*It was the best of times, it was the worst of times, it was the age of wisdom, it was the age of foolishness, it was the epoch of belief, it was the epoch of incredulity, it was the season of Light, it was the season of Darkness, it was the spring of hope, it was the winter of despair...*

- Charles Dickens, *A Tale of Two Cities* (1895)

### 1.1 Introduction

The world has moved into an extremely interesting time of change and uncertainty with the United Kingdom exiting the European Union, President Donald Trump leading the United States, and the Chinese President Xi Jinping advocating globalisation at the United Nations and the World Economic Forum. The same is equally visible in the international investment law regime.<sup>1</sup> Liberalisation of the investment law regime carries on as a general practice - with yet more investment treaties signed on the international stage and more liberalising measures adopted at the domestic level, increasingly states are taking a more cautious and restrictive approach in regulating international investments.

One of the many demonstrations of such change and uncertainty is the remarkable rise of international investments made by state-owned enterprises (SOEs) and consequential regulatory responses mounted by some major host states. The United Nations Conference on Trade and Development (UNCTAD) statistics show that, for instance, 15 per cent of the 100 largest multinational enterprises (MNEs) in the world are SO-MNEs. A considerable number of these are from developing and

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<sup>1</sup> A regime is traditionally understood as the 'principles, norms, rules, and decision-making procedures around which actors' expectations coverage in a given area of international relations', Stephen D Krasner, *Power, the State, and Sovereignty: Essays on International Relations* (Routledge 2009) 113. For the purpose of this study, the international investment law regime refers to international investment treaties and investment arbitrations.

transition economies, concentrated in industries of public interest and strategic importance.<sup>2</sup> As a consequence, some developed states have taken domestic and international measures to tighten the review and regulation of SOE investments due to a wide range of concerns, particularly national security and competitive distortion concerns.<sup>3</sup> Such practices have undoubtedly added further complexity, divergence and uncertainty to the already troubled field of international investment law.

Against this backdrop, it is important to explore and analyse whether and to what extent the rise of SOE investment affects the international investment law regime and how the regime should respond to emerging changes and uncertainty. However, little seems to have been done on this front. This thesis, therefore, attempts to take up the challenge by providing a systematic and novel review and analysis of the most important provisions of international investment treaties, in order to evaluate whether and to what extent the current investment law regime is adequately equipped to respond to policy challenges posed by SOE investments. This thesis focuses on issues broader than SOEs only. Rather, it covers a wide-range of issues relating to investment protections, investment promotion and liberalisation, and host states' regulatory rights that need to be addressed in today's world. The landscape of international investment has been changing significantly over the past decade, with a surge of SOE investments and a rise of state capitalism. On the one hand, the evolving regime of investment law and policy calls for more liberalisation at the international level. But on the other hand, it puts in place more protectionist measures at national levels. Hence, the resulting international investment law regime has been contested by policymakers, scholars, lawyers and stakeholders in order to achieve proper balance and sustainability. I hope this thesis can make a useful contribution towards such an endeavour.

As an introductory chapter, the following sections will first elaborate on the changing landscape in international investment law and the challenges posed by the

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<sup>2</sup> UNCTAD, *World Investment Report 2017- Investment and Digital Economy* (UN Publication 2017) 32.

<sup>3</sup> Lu Wang and Norah Gallagher, 'Introduction to the Special Focus Issue on State-Owned Enterprises' (2016) 31 ICSID Review 1, 1; UNCTAD, *World Investment Report 2011 - Non-Equity Modes of International Production and Development* (UN Publication 2011) 36–7; Wouter PF Schmit Jongbloed, Lisa E Sachs and Karl P Sauvant, 'Sovereign Investment: An Introduction' in Karl P Sauvant, Lisa E Sachs and Wouter PF Schmit Jongbloed (eds), *Sovereign Investment: Concerns and Policy Reactions* (OUP 2012) 10–6.



rise of SOEs to the existing investment regime. It will then set out the overall design of the thesis, including its purposes, methods, structures and main findings.

## 1.2 The Changing Landscape of International Investment Law

The landscape of international investment and its governing regime has undergone dramatic changes in the past decades, especially following the global economic and financial crisis of 2008-2009.<sup>4</sup> To begin with, global foreign direct investment (FDI) inflows fell from a historic high of \$1,979 billion in 2007 to \$1,697 billion in 2008.<sup>5</sup> While global FDI flows rose by 38 per cent to \$1.76 trillion in 2015 - the highest level since the crisis and a modest recovery of which is forecast for 2017 - they still remained well below the pre-crisis peak (Figure 1.1).<sup>6</sup> This crisis has coincided with new trends in international investment, notably with a surge of FDI from developing and transition economies.<sup>7</sup> Some developing economies have now become important sources of FDI.<sup>8</sup> The latest World Investment Report (WIR) shows that developing economies saw their FDI inflows reach \$646 billion in 2016, which together with transition economies accounted for 6 of the top 10 host economies.<sup>9</sup> Meanwhile, FDI outflows from developed countries declined by 11 percent to \$1 trillion in 2016 (Figure 1.2), but those from developing countries slipped 1 per cent to \$383 billion, despite a surge which saw China rising 44 per cent to \$183 billion as the second largest home country for FDI for the first time.<sup>10</sup> To a certain extent, the pattern of

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<sup>4</sup> UNCTAD, *World Investment Report 2009 - Transnational Corporations, Agricultural Production and Development* (UN Publication 2009) xvii.

<sup>5</sup> *ibid* xix.

<sup>6</sup> UNCTAD, *WIR 2017* (n 2) 2.

<sup>7</sup> For example, by 2010, FDI inflows to developing economies and together with transition economies- for the first time- absorbed more than half of global FDI flows, UNCTAD, *WIR 2011* (n 3) 3.

<sup>8</sup> According to UNCTAD's survey, while developed countries remain the dominant role in FDI outflows, major developing countries such as the BRICs, the UAE, the Republic of Korea and Turkey are also important sources of FDI. UNCTAD, 'World Investment Prospects Survey 2014-2016' (2014) 11

<[http://unctad.org/en/PublicationsLibrary/webdiaeia2015d4\\_en.pdf](http://unctad.org/en/PublicationsLibrary/webdiaeia2015d4_en.pdf)> accessed 12 September 2017. In particular, China is not only the largest host country for FDI among developing economies (the third largest worldwide in 2016), but also the second largest FDI home country among both developing and developed economies, UNCTAD, *WIR 2017* (n 2) 14.

<sup>9</sup> The US remained the largest recipient of FDI with \$391 billion in inflows, followed by the UK with \$254 billion, and China was in third position with inflows of \$135 billion, *ibid* 11.

<sup>10</sup> *ibid* 11, 13-4. Notably, according to the latest World Investment Prospects Survey by UNCTAD, China continues as the most promising source of FDI, closely followed by the United States, Germany and United Kingdom; among emerging economies, the UAE, the Republic of Korea and Turkey have improved standing

FDI flows has changed from the traditional ‘one-way street’ (from developed countries to developing countries) to the recent ‘two-way interchange’.

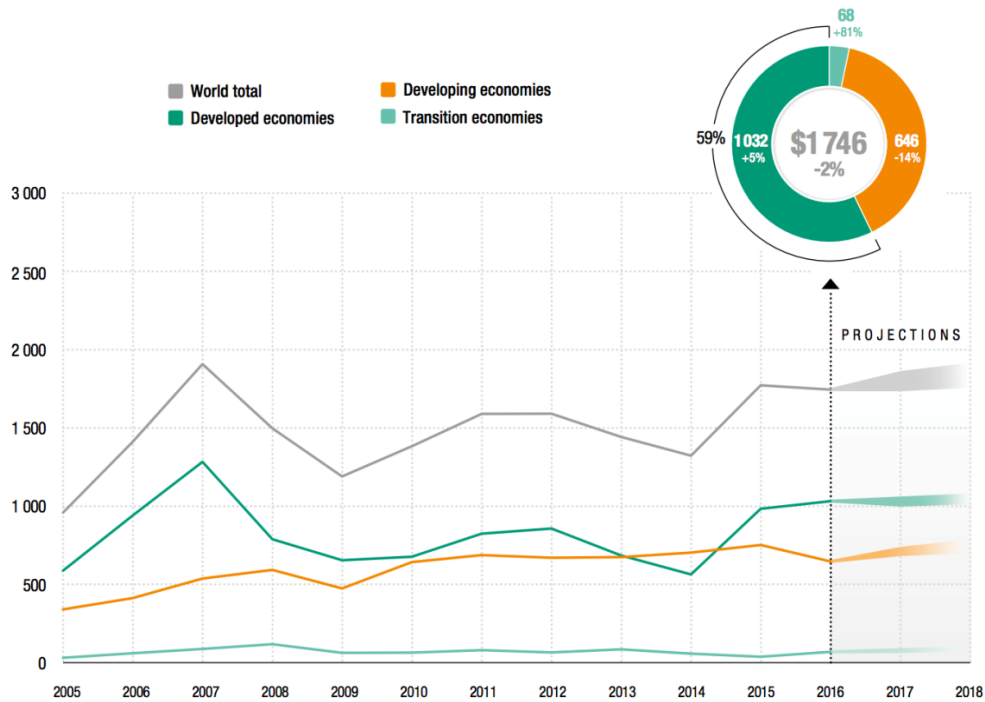


Figure 1.1 FDI inflows, global and by group of economies, 2005-2016, and projections 2017-2018 (Billions of dollars and per cent)

Source: UNCTAD, *WIR 2017*, based on information from FDI/MNE database  
<[www.unctad.org/fdistatistics](http://www.unctad.org/fdistatistics)>

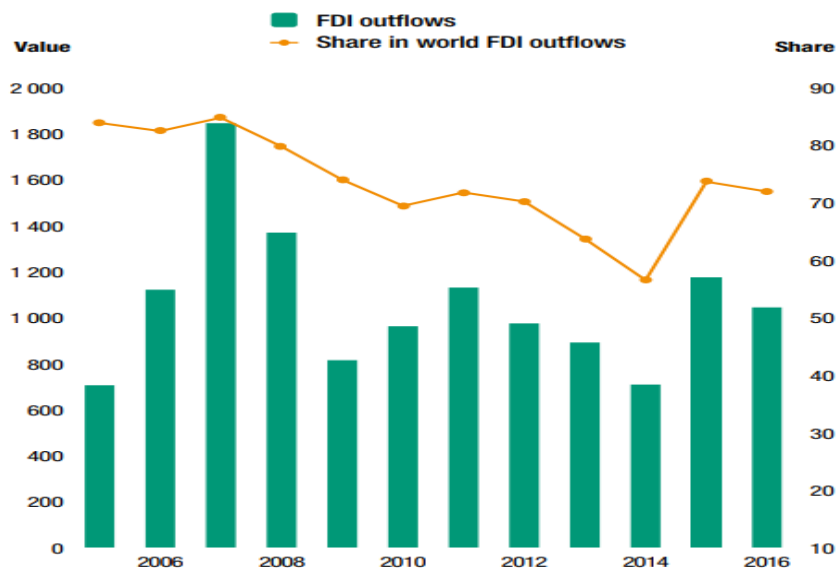


Figure 1.2 Developed economies: FDI outflows and their share in world outflows, 2005-2016 (Billions of dollars and per cent)

after a temporary setback, UNCTAD, ‘World Investment Prospects Survey 2014-2016’ (n 8) 8.

Source: UNCTAD, *WIR 2017*, based on information from FDI/MNE database  
<[www.unctad.org/fdistatistics](http://www.unctad.org/fdistatistics)>

The international investment law regime has been affected accordingly. Today, the universe of international investment agreements (IIAs) contains about 3,324 treaties in total, including 2,957 bilateral investment treaties (BITs) and 367 treaties with investment provisions (TIPs) (Figure 1.3).<sup>11</sup> However, the expansive network of IIAs has been criticised as a ‘spaghetti bowl’, which is highly fragmented and complex with numerous problems such as how the various (or diverging) investment protections and commitments interact and whether it is possible to disentangle the spaghetti strand of IIAs through regional and multilateral approaches.<sup>12</sup>

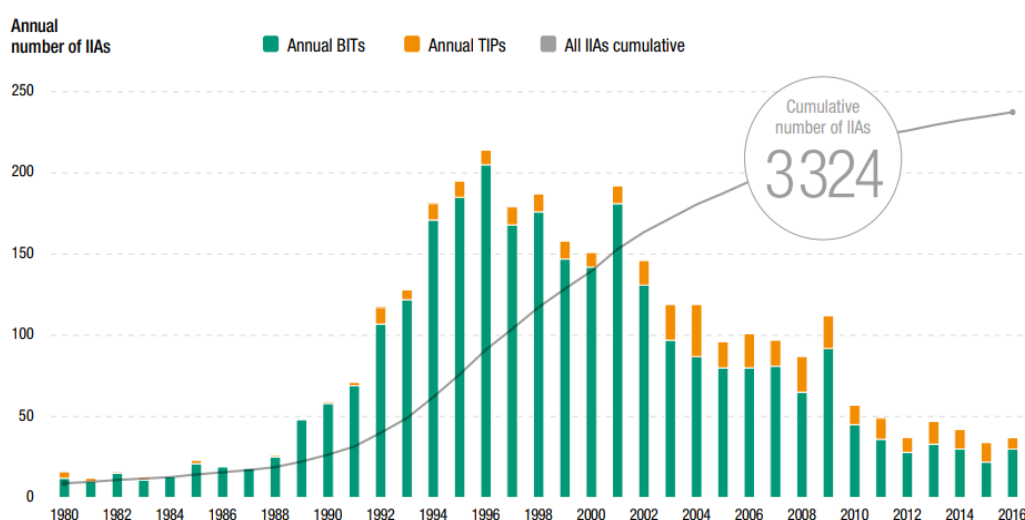


Figure 1.3 Trends in IIAs signed, 1980-2016

Source: UNCTAD, *WIR 2017*, based on information from IIA Navigator  
<<http://investmentpolicyhub.unctad.org/IIA>>

In recent years, international investment policymaking has been facing mounting challenges associated with some notable trends. First, at the systematic level, the regime of IIAs is becoming more complex and uncertain.<sup>13</sup> While countries continue to sign and negotiate new IIAs, a few countries such as Ecuador, Venezuela, South

<sup>11</sup> *ibid* 111.

<sup>12</sup> James Zhan, ‘Investment Policies for Sustainable Development: Addressing Policy Challenges in A New Investment Landscape’ in Roberto Echandi (ed), *Prospects in International Investment Law and Policy: World Trade Forum* (CUP 2013) 21–2.

<sup>13</sup> UNCTAD, *WIR 2017* (n 2) 22.

Africa and Indonesia have also begun to terminate some of their IIAs.<sup>14</sup> Between January 1<sup>st</sup> 2016 and April 1<sup>st</sup> 2017, for instance, terminations became effective for at least 19 IIAs, with more scheduled to take effect later this year.<sup>15</sup> Furthermore, the US decided to withdraw from the Trans-Pacific Partnership Agreement (TPP) in 2016, although it had never been approved by Congress, and started to renegotiate the North American Free Trade Agreement (NAFTA) in 2017.<sup>16</sup> A question may arise about whether the withdrawal from the TPP signifies a paradigmatic shift in international investment law and heralds an era of retreat from international investment treaties. Meanwhile, countries have been in recent years actively engaged in international investment policy-making at the regional level. An increasing number of mega-regional agreements and plurilateral agreements have been concluded or entering negotiations, including the Canada-EU Comprehensive Economic and Trade Agreement (CETA), the TPP, the Regional Comprehensive Economic Partnership (RCEP) and the Transatlantic Trade and Investment Partnership (TTIP).<sup>17</sup> Another question may arise about whether the proliferation of mega-regionals is going to change the content and future direction of international investment law.

Secondly, recent investment treaties have revealed two divergent tendencies. On the one hand, while investment treaties have traditionally focused on investment protections against discrimination and uncompensated expropriation, a growing number of IIAs include investment liberalisation rules to extend national treatment

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<sup>14</sup> In fact, after the ‘golden age’ of the BIT movement in 1990s, many states are now realising the potential liabilities of signing an international treaty, which in turn has prompted a slowdown in treaty adoption, see Jonathan Bonnitcha, Lauge N Skovgaard Poulsen and Michael Waibel, *The Political Economy of the Investment Treaty Regime* (OUP 2017) 21.

<sup>15</sup> Of the 19 terminated IIAs, 16 were unilaterally denounced, 1 was terminated by consent (the 1995 Argentina–Indonesia BIT), and 2 were replaced by a new treaty (the Japan–Mongolia BIT and the European Communities–Ukraine Cooperation Agreement), UNCTAD, *WIR 2017* (n 2)112.

<sup>16</sup> See, for instance, ‘Trump says US to quit TPP on first day in office’ *BBC* (US & Canada, 22 November 2016) <<http://www.bbc.co.uk/news/world-us-canada-38059623>> accessed 12 September 2017. In April 2017, President Trump warned that the US could terminate the NAFTA if it did not get a ‘fairer deal’ from the negotiation, see Shawn Donnan, Jude Webber and Anna Nicolaou, ‘Trump renews US threat to withdraw from Nafta’ *Financial Times* (New York, 27 April 2017) <<https://www.ft.com/content/4f4c269e-2b68-11e7-9ec8-168383da43b7>> accessed 12 September 2017.

<sup>17</sup> The CETA and the TPP were concluded in 2016, while the RCEP, the TTIP and other regional agreements including the African Continental Free Trade Area (CFTA) and the Trade in Services Agreement (TISA) remain at various stages of negotiation.

(NT) and most-favoured-nation treatment (MFN) obligations to the pre-establishment phase of investment (Figure 1.4).<sup>18</sup> Some economies that had been reluctant to accept admission obligations, such as China, have begun to accept pre-establishment NT obligations on the basis of a ‘negative list’ of reserved sectors in BIT negotiations.<sup>19</sup> The rise of pre-establishment IIAs has gradually affected domestic investment regulations on admission of foreign investment.<sup>20</sup> Numerous countries have taken measures to ease entry and establishment conditions for foreign investors, whilst investment liberalisation and promotion continuously predominate in national investment policy measures (Figure 1.5).<sup>21</sup>

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<sup>18</sup> The bulk of investment treaties concluded by European countries and following European templates have traditionally been silent on the admission of foreign investment. However, the US treaties, unlike European treaties, have typically extended national and most-favored-nation treatment to the pre-establishment phase from the beginning, see e.g., Kenneth J Vandevelde, *U.S. International Investment Agreements* (OUP 2009) 236. In recent year, a growing number of investment treaties have followed the US approach of extending NT and MFN to the pre-establishment phase, most of which involved developed economies - especially Canada, Japan, Finland and the EU; also, a few developing countries are actively concluding pre-establishment IIAs, such as Chile, Costa Rica, the Republic of Korea, Peru and Singapore, UNCTAD, *World Investment Report 2015 - Reforming International Investment Governance* (UN Publication 2015) 110. By the end of 2014, 228 IIAs have pre-establishment commitments, and such practice is also enshrined in mega-regional TPP, RCEP and TTIP.

<sup>19</sup> MOFCOM, ‘Spokesman Sun Jiwen comments on great progress made in US-China BIT negotiations’ (Beijing, 6 September 2016)

<<http://english.mofcom.gov.cn/article/newsrelease/policyreleasing/201609/20160901389177.shtml>> accessed 12 September 2017; Wenhua Shan and Lu Wang, ‘The China-EU BIT and the Emerging “Global BIT 2.0”’ (2015) 30 (1) ICSID Review 260, 261. Also, in the investment chapter of CETA, both the EU and Canada have agreed to extensive market access commitments with carve-out exceptions (Article 8.4) and extended non-discriminatory treatment to pre-establishment phase investment (Article 8.6 & 8.7). See also Ch 3.

<sup>20</sup> Pre-establishment commitments may improve the host countries’ openness for foreign investments, whilst helping home countries ‘lock in’ existing levels of openness, see UNCTAD, *WIR 2015* (n 18) 111–2.

<sup>21</sup> Investment liberalisation and promotion measures include promulgating new investment laws, establishing special economic zones, reforming domestic investment dispute resolution system, expanding privatisation, adopting new public-private partnership regime, etc. Furthermore, national policy measures for FDI liberalization is most active in emerging economies in 2016 including India, China, and the Russian Federation, UNCTAD, *WIR 2017* (n 2) 100–3.

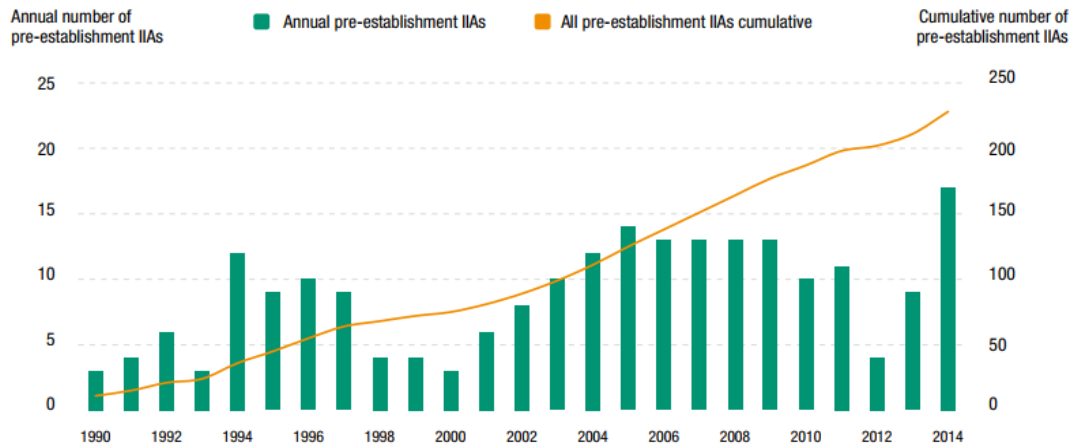


Figure 1.4 Trends in pre-establishment IIAs signed, 1990-2014

Source: UNCTAD, *WIR 2015*, based on information from IIA database  
<http://investmentpolicyhub.unctad.org>

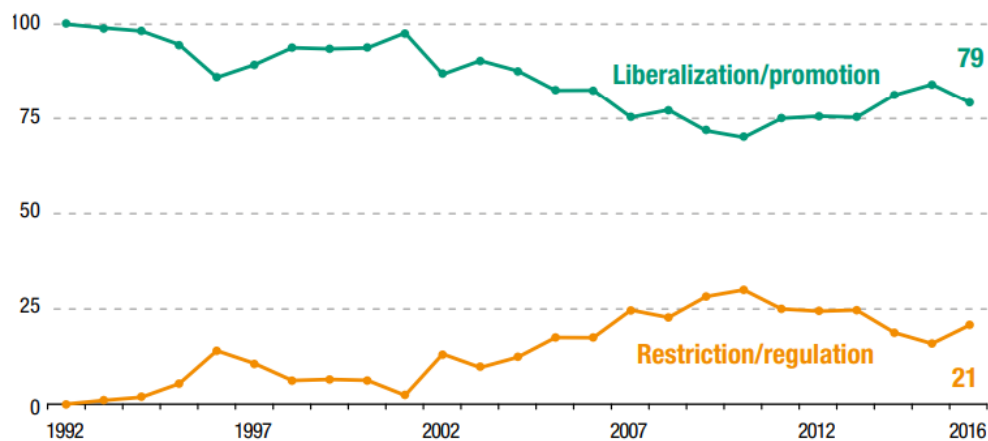


Figure 1.5 Changes in national investment policies, 1992-2016 (Per cent)

Source: UNCTAD, *WIR 2017*, based on information from Investment Policy Monitor Database  
<http://investmentpolicyhub.unctad.org/IPM>

On the other hand, however, some of the recent IIAs tend to refine and reform substantive provisions to preserve necessary regulatory rights of host states for pursuing national interests. For example, some IIAs have refined and clarified the definition of investment and general standards of investment protection such as NT, MFN, fair and equitable treatment (FET), right to transfer, and expropriation and compensation.<sup>22</sup> Moreover, general and specific exceptions have become common in

<sup>22</sup> The reform in new IIAs includes, for example, narrowing the scope of treaty protections by excluding certain types of assets from the definition of investment; refining the definition of investment with a reference to characteristics of investment; clarifying the treatment standards by including more details, such as equating FET to the minimum standard of treatment under customary international law or explicitly providing what does and

recent treaties that allow host states to pursue regulatory objectives such as protecting public health and safety without a violation of investment treaty obligations.<sup>23</sup> Some states have provided provisions to address a wide range of concerns on environment and labour protections, transparency, corporate behaviours, fair competition and anti-corruption.<sup>24</sup> Meanwhile, national restrictive measures for foreign investors is rising (Figure 1.5). A question then arises whether the recent practice could achieve a balance between protecting foreign investors' investments and protecting host states' right to regulate, or would detract from investment protection and dissimulate protectionism ends.

Finally, debates on the reform of investor-state dispute settlement (ISDS) reached a new level. On the one hand, the number of ISDS cases continues to grow (Figure 1.6).<sup>25</sup> Many developing countries and transition economies have been facing huge amounts of compensation to foreign investors, such as Argentina, Venezuela, Czech Republic and the Russian Federation.<sup>26</sup> On the other hand, the share of cases against developed states is on the rise. Before 2013, fewer cases were brought against developed countries, but between 2014 and 2015, above 40 per cent of all cases were against developed countries.<sup>27</sup> As a result, developed countries that traditionally

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does not constitute an indirect expropriation; providing exceptions to transfer-of-funds obligations; limiting treaty provisions that are subject to the international investment arbitration; etc. UNCTAD, *WIR 2015* (n 18) 112; UNCTAD, *WIR 2016* (n 3) 111; UNCTAD, *WIR 2017* (n 2) 120.

<sup>23</sup> For example, some IIAs exclude taxation, financial services or government procurement from the scope of treaty; some IIAs provide general exceptions for the protection of human, animal or plant life or health, or the conservation of exhaustible natural resources; some IIAs explicitly include self-judging clauses to protect essential security interests of host states. See also Chapter 4 and Chapter 5.

<sup>24</sup> For example, some IIAs provide provisions to ensure responsible investment, such as a corporate social responsibility (CSR) clause or a 'not lowering of standard' clause. For more see *ibid* 122–3; UNCTAD, *WIR 2016* (n 3) 111–2. Also, some recent IIAs, especially FTAs, have provided rules on competition policies, such as the Singapore-Australia FTA (Chapter 12), CETA (Chapter Seven) and the TPP (Chapter 16).

<sup>25</sup> According to the latest *World Investment Report*, 62 new cases were initiated in 2016, bringing the total number of known cases to 767; in addition, investors won 60 per cent of the total known cases decided on merits, UNCTAD, *WIR 2017* (n 2) 114.

<sup>26</sup> Argentina, Venezuela and Czech Republic are the most frequent respondent states that have been subject to dozens of arbitrations over the past decades. In 2007, the Hague's arbitration court (PCA) ruled that Russia must pay a group of shareholders in Yukos around \$50 billion for expropriation, although the award was overruled by domestic courts, see Neil Buckley, 'Dutch court rejects \$50bn Yukos award against Russia' *Financial Times* (20 April 2016) <<https://www.ft.com/content/9d3aa3d5-432f-3b2a-96c5-d10e0f61bc3c>> accessed 12 September 2017; Stanley Reed, 'Dutch Court Overturns \$50 Billion Ruling Against Russia in Yukos Case' *The New York Times* (London, 20 April 2016) <<https://www.nytimes.com/2016/04/21/business/international/yukos-russia-50-billion-ruling.html>> accessed 12 September 2017.

<sup>27</sup> UNCTAD, *WIR 2016* (n 3) 105.

relied upon the ISDS for protecting their foreign investors and investments are increasingly ‘bitten’ by the dispute resolution mechanism.<sup>28</sup> A famous example is two *Vattenfall* cases against Germany, which implies that international investment arbitration is no longer a ‘one-way street’.<sup>29</sup> Hence, both developing and developed countries today have to be cautious on the possible constraining effects that IIAs and ISDS may have on their ability to regulate foreign investments in the public interest, such as in areas of public health safety and environment protection.<sup>30</sup> Also, a number of concerns in relation to the current ISDS system have brought increasing criticisms. These include concerns relating to the deficit of legitimacy and transparency, contradictions between arbitral awards, difficulties in correcting erroneous arbitral decisions, questions about the independence and impartiality of arbitrators, and the cost and time of arbitral procedures.<sup>31</sup> As a result, paths for reforming the ISDS have

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<sup>28</sup> Traditionally, most arbitrations have been brought by investors from developed countries against developing and transition states. However, an increasing number of cases in recent years have been brought against developed countries. According to UNCTAD’s statistics, Spain (34), Canada (26) and US (16) are among the top 20 frequent respondent states, see UNCTAD, ‘International Dispute Settlement’

<<http://investmentpolicyhub.unctad.org/ISDS/FilterByCountry>> accessed 22 August 2017. Notably, some investors from developing countries also have started to use ISDS for treaty protections. In 2016, for example, investors from the Russian Federation, Turkey, Ukraine and the UAE were the most active claimants from developing countries and transition economies. So far, 109 countries including both developed and developing countries have been respondents to one or more known ISDS claim. UNCTAD, *WIR 2017* (n 2) 115.

<sup>29</sup> In 2009, a Swedish company, Vattenfall, filed its first case against Germany under the 1991 Energy Charter Treaty (ECT), alleging that restrictive measures imposed by local authorities constituted expropriation and unfair treatment and claiming more than \$1.4 billion compensation. In 2012, Vattenfall filed a second arbitration against Germany under the ECT, where the dispute arose from Germany’s decision to phase out nuclear power stations. For the first *Vattenfall v. Germany*, ICSID Case No. ARB/09/6, Award, 11 March 2011; for more discussion on the second *Vattenfall* case, see Nathalie Bernasconi-Osterwalder and Rhea Tamara Hoffman, ‘The German Nuclear Phase-Out Put to the Test in International Investment Arbitration? Background to the New Dispute Vattenfall v Germany (II)’ [2012] IISD Briefing Note

<[http://www.iisd.org/pdf/2012/german\\_nuclear\\_phase\\_out.pdf](http://www.iisd.org/pdf/2012/german_nuclear_phase_out.pdf)> accessed 12 September 2017; Nathalie Bernasconi-Osterwalder and Martin Dietrich Brauch, ‘The State of Play in Vattenfall v. Germany II: Leaving the German Public in the Dark’ [2014] IISD Briefing Note <<http://www.iisd.org/sites/default/files/publications/state-of-play-vattenfall-vs-germany-II-leaving-german-public-dark-en.pdf>> accessed 12 September 2017. See also Bonnitche, Poulsen and Waibel (n 14) 27.

<sup>30</sup> For instance, two claims were brought by the Philip Morris tobacco company against Australia and Uruguay where investors contested legislation on tobacco packaging on the grounds that it violated IIAs. *Philip Morris Asia Limited v. The Commonwealth of Australia*, PCA Case No. 2012-12, Award on Jurisdiction and Admissibility, 17 December 2015; *Philip Morris Brands Sàrl, Philip Morris Products S.A. and Abal Hermanos S.A. v. Oriental Republic of Uruguay*, ICSID Case No. ARB/10/7, Award, 8 July 2016.

<sup>31</sup> UNCTAD, ‘Reform of Investor-State Dispute Settlement: In Search of A Roadmap’ (2013) 2 <[http://unctad.org/en/PublicationsLibrary/webdiaepcb2013d4\\_en.pdf](http://unctad.org/en/PublicationsLibrary/webdiaepcb2013d4_en.pdf)> accessed 12 September 2017. See also Bonnitche, Poulsen and Waibel (n 14) 28–30. Notably, since October 2016, the International Centre for Settlement of Investment Disputes (ICSID) has begun work on updating and modernizing its rules and regulations, see ICSID, ‘Update on ICSID Rule Amendment’



emerged in recent years, including clarifying substantive provisions, limiting investor access to ISDS and setting rules for greater transparency in investment arbitrations.<sup>32</sup> In particular, the EU has proposed an investment court system (ICS) to replace the current ISDS regime, which is now updated to a multilateral ICS.<sup>33</sup> The United Nations Commission on International Trade Law (UNCITRAL) has also agreed to start work on the multilateral reform of ISDS.<sup>34</sup> However, the reform of investment dispute resolution still requires numerous debates, and it is yet to be seen whether the investment dispute settlement system is to be ratified with a revised ISDS or the ICS, or alternative global mechanisms.<sup>35</sup>

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Project' <<https://icsid.worldbank.org/en/Pages/resources/ICSID%20NewsLetter/2017-Issue2/Update-on-ICSID-Rule-Amendment-Project.aspx>> accessed 12 September 2017.

<sup>32</sup> In 2014, the United Nations Commission on International Trade Law (UNCITRAL) provided the Rules on Transparency in Treaty-based Investor-State Arbitration for greater transparency, which has come into force. The United Nations has then adopted a Convention on the Rules on Transparency ('Mauritius Convention on Transparency') which is an instrument for parties to apply the Rules on Transparency. For a full text of the UNCITRAL Rules see <<https://www.uncitral.org/pdf/english/texts/arbitration/rules-on-transparency/Rules-on-Transparency-E.pdf>> accessed 12 September 2017. In addition, the International Centre for Settlement of Investment Disputes (ICSID) launched the current amendment process in 2016 and published potential areas for amendment for public consultation, for more information see

<<https://icsid.worldbank.org/en/Documents/about/ICSID%20Rules%20Amendment%20Process-ENG.pdf>> accessed 12 September 2017. See also UNCTAD, 'Reform of Investor-State Dispute Settlement: In Search of A Roadmap' (n 31); Stephan W Schill, 'Reforming Investor-State Dispute Settlement (ISDS): Conceptual Framework and Options for the Way Forward' (ICTSD and World Economic Forum, 2015) E15 Initiative <<http://e15initiative.org/publications/reforming-investor-state-dispute-settlement-isd-conceptual-framework-and-options-for-the-way-forward/>> accessed 12 September 2017; Piero Bernardini, 'Reforming Investor-State Dispute Settlement: The Need to Balance Both Parties' (2017) 32 ICSID Review 38.

<sup>33</sup> Both the CETA and the EU-Vietnam Free Trade Agreement (EUVFTA) include provisions anticipating the transition from the bilateral ICS included in the agreements to a permanent Multilateral Investment Court. To ensure policy coherence at EU level, similar transitional provisions are proposed in the context of all other ongoing or future bilateral EU trade and/or investment negotiations.

<sup>34</sup> Timothy Lemay, 'UNCITRAL to consider possible reform of investor-State dispute settlement' *UNCITRAL* (14 July 2017) <<http://www.unis.unvienna.org/unis/en/pressrels/2017/unisl250.html>> accessed 12 September 2017.

<sup>35</sup> A typical case is the current TTIP negotiations. For more discussion see e.g., Wolfgang Koeth, 'Can the Investment Court System (ICS) Save TTIP and CETA?' (EIPA 2016) 2016/W/01 <[http://www.eipa.eu/files/repository/product/20160921135556\\_Workingpaper2016\\_W\\_01.pdf](http://www.eipa.eu/files/repository/product/20160921135556_Workingpaper2016_W_01.pdf)> accessed 12 September 2017.

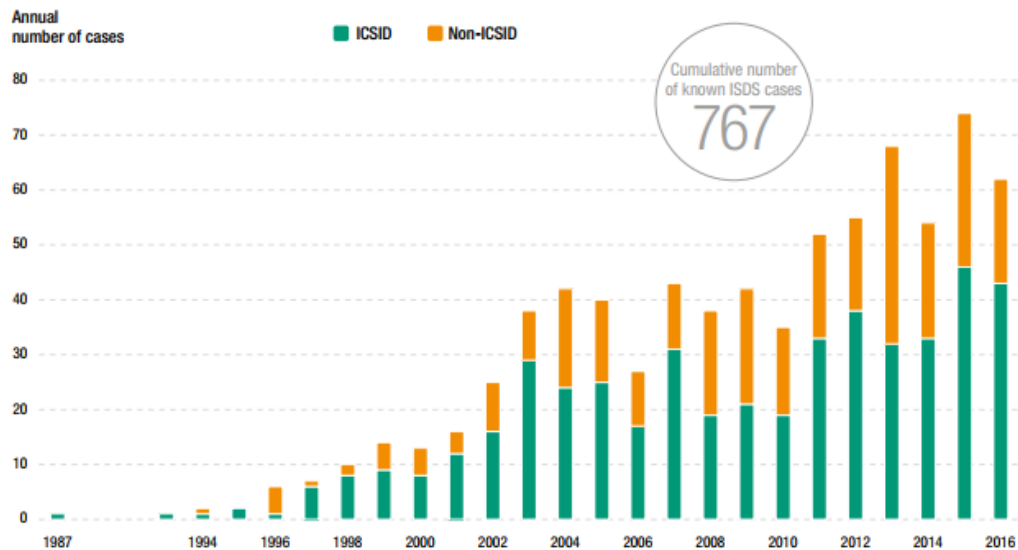


Figure 1.6 Trends in known treaty-based ISDS cases, 1987-2016

Source: UNCTAD, *WIR 2017*, based on information from ISDS Navigator  
<<http://investmentpolicyhub.unctad.org/ISDS>>

There is no doubt that the landscape of international investment has changed drastically over the past decades and the international investment law regime has never before faced as many challenges and debates as today. Investment policymaking in the twenty-first century is becoming more complex, divergent and uncertain. A question, therefore, arises about how best to equip the investment law and policy regime with the new reality of global investment. Notably, in July 2016, the G20 countries adopted non-binding Guiding Principles for Global Investment Policymaking, which has provided the blueprint for a new generation of investment policies and reached multilateral consensus on investment matters and sustainable development for the first time.<sup>36</sup>

<sup>36</sup> European Commission, 'G20 Trade Ministers Meeting Statement: Annex III' (Shanghai, 9-10 July 2016) <[https://www.wto.org/english/news\\_e/news16\\_e/dgra\\_09jul16\\_e.pdf](https://www.wto.org/english/news_e/news16_e/dgra_09jul16_e.pdf)> accessed 12 September 2017. See also James Zhan, 'G20 Guiding Principles for Global Investment Policymaking: A Facilitator's Perspective' (ICTSD and World Economic Forum 2016) *The E15 Initiative* <<http://e15initiative.org/wp-content/uploads/2015/09/E15-Investment-Zhan-Final-1.pdf>> accessed 12 September 2017; Karl P Sauvart, 'China Moves the G20 Toward an International Investment Framework and Investment Facilitation' (2017) <[https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2901156](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2901156)> accessed 12 September 2017; Anna Joubin-Bret and Cristian Rodriguez Chiffelle, 'G20 Guiding Principles for Global Investment Policymaking: A Stepping Stone for Multilateral Rules on Investment' (ICTSD and World Economic Forum 2017) *The E15 Initiative* <<http://e15initiative.org/publications/g20-guiding-principles-for-global-investment-policymaking-a-stepping-stone-for-multilateral-rules-on-investment/>> accessed 12 September 2017.

### 1.3 The Rising Role of SOEs in International Investment Landscape: Concerns and Challenges

While SOEs are not new in the marketplace, their rapid international expansion is a relatively new and very important phenomenon in the international economy of the twenty-first century.<sup>37</sup> The rationale behind the emergence of SOEs varies among countries and industries. Traditionally, the creation of SOEs can be a result of ideology and political strategy of some governments because it was thought that the state ownership could speed up the national development and achieve public policy objectives. In economics, governments may intervene the economy via SOEs as a solution to market failures. Unlike private-owned firms that focus on profit-maximising, SOEs are considered to be driven by both political and economic motivations where the state-owned nature plays a significant role. Nonetheless, there is no universally agreed definition of SOEs. The World Bank defines SOEs as ‘government owned or government controlled economic entities that generate the bulk of their revenues from selling goods and services’.<sup>38</sup> According to UNCTAD, SOEs are defined as ‘enterprises comprising parent enterprises and their foreign affiliates in which the government (both national and sub-national) has a controlling interest (full, majority, or significant minority), whether or not listed on a stock exchange’.<sup>39</sup> What defines a controlling interest in each case may differ, but UNCTAD defines control as ‘a stake of 10 per cent or more of the voting power, or where the government is the largest single shareholder’; in addition, a government can control an entity through a ‘golden share’ that gives special voting rights and the ability to block key strategic decisions, especially takeovers by other shareholders.<sup>40</sup>

<sup>37</sup> Cuervo-Cazurra Alvaro and others, ‘Governments as Owners: State-Owned Multinational Companies’ (2014) 45 *Journal of International Business Studies* 919, 919–20; OECD, *State-Owned Enterprises as Global Competitors: A Challenge or An Opportunity?* (OECD Publishing 2016) 13; Przemyslaw Kowalski and Kateryna Perepechay, ‘International Trade and Investment by State Enterprises’ (2015) 184 7 <<http://dx.doi.org/10.1787/5jrtcr9x6c48-en%0AOECD>> accessed 11 September 2017; Muthucumaraswamy Sornarajah, *The International Law on Foreign Investment* (Third Edition, Cambridge University Press 2010) 63; UNCTAD, *WIR 2011* (n 3) 3; UNCTAD, *WIR 2017* (n 2) xi.

<sup>38</sup> World Bank, *Bureaucrats in Business: The Economics and Politics of Government Ownership* (OUP 1995) 263.

<sup>39</sup> UNCTAD, *WIR 2011* (n ) 28.

<sup>40</sup> *ibid*; UNCTAD, *WIR 2017* (n 2) 30. Likewise, the OECD provides that the control of the state includes either the state being the ultimate beneficiary owner of the majority of voting shares or otherwise exercising an equivalent degree of control, see *OECD Guidelines on Corporate Governance of State-Owned Enterprises* (2015 Edition), OECD Publishing 2015) 14. Similar definitions see e.g., Sebastien Miroudot and Alexandros Ragoussis,

For the purpose of this study, this thesis will accept UNCTAD's definition of SOEs in general. For clarity, the term SOEs exclude sovereign wealth funds (SWFs) because they are not enterprises and are not necessarily governed by the usual corporate mechanisms, despite the similarity in state ownership and prominence in FDI.<sup>41</sup> However, it is notable that SWFs often create sovereign wealth enterprises (SWEs) to make foreign investments where the SWEs can be regarded as a special kind of SOEs.<sup>42</sup> Nevertheless, this thesis will mainly focus on SOEs and SOE investments, unless otherwise specified.

### 1.3.1 The Rising Role of SOE Investments

SOEs as a relatively new global actor contribute to the changing landscape of international investments.<sup>43</sup> Over the past 15 years SOEs have not diminished but have undergone a dramatic revival.<sup>44</sup> As estimated by the Organisation for Economic Co-operation and Development (OECD), 22% of the world's largest 100 firms are now effectively under state control, reaching the highest percentage in decades.<sup>45</sup>

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'Actors in the International Investment Scenario: Objectives, Performance and Advantages of Affiliates of State-Owned Enterprises and Sovereign Wealth Funds' in Pierre Sauvé and Roberto Echandi (eds), *Prospects in International Investment Law and Policy: World Trade Forum* (CUP 2013) 56; Adrian Blundell-Wignall and Gert Wehinger, 'Open Capital Markets and Sovereign Wealth Funds, Pension Funds, and State-Owned Enterprises' in RA Fry, WJ McKibbin and J O'Brien (eds), *Sovereign Wealth: The Role of State Capital in the New Financial Order* (Imperial College Press 2011) 107.

<sup>41</sup> SWFs are special-purpose investment funds or arrangements that are owned by government, *WIR 2011* (n 3), 14. The concept was created by Rozanov in 2005 who defined SWFs as sovereign-owned asset pools which are neither traditional public pension funds nor reserve assets supporting national currencies, Andrew Rozanov, 'Who Holds the Wealth of Nations?' (2005) 15 *Central Banking Journal* 52, 4; Fabio Bassan, 'Sovereign Wealth Funds: A Definition and Classification' in Fabio Bassan (ed), *Research Handbook on Sovereign Wealth Funds and International Investment Law* (EE Publishing 2015).

<sup>42</sup> However, some scholars argue that SWEs and SOEs are still different in management, purposes and behaviors, see Larry Catá Backer, 'Sovereign Investing in Times of Crisis: Global Regulation of Sovereign Wealth Funds, State-Owned Enterprises, and the Chinese Experience' (2010) 19 *Transnational Law and Contemporary Problems* 4, 3–144; Blundell-Wignall and Wehinger (n 40) 105.

<sup>43</sup> Zhan, 'Investment Policies for Sustainable Development: Addressing Policy Challenges in A New Investment Landscape' (n 12) 15; UNCTAD, *WIR 2011* (n 3) 28.

<sup>44</sup> In the 1990s the demise of central planned economies and free market reforms in developing countries has triggered massive privatisations. According to the World Bank's privatisation database, 8342 large-scale privatisations (more than US\$1 million) occurred between 1988 and 1999 in 108 countries, see Miroudot and Ragoussis (n 40) 51. Against this background, the assumption was that 'as the economy matured, the government would close or privatise them', Editorial, 'The Special Report on "The Rise of State Capitalism"' *The Economist* (21 Jan 2012) <<http://www.economist.com/node/21543160>> accessed 12 September 2017.

<sup>45</sup> OECD, *State-Owned Enterprises as Global Competitors: A Challenge or An Opportunity?* (n 37) 13.

According to UNCTAD, while the number of SOEs continues to remain a small minority - only 1.5 per cent - of

UNCTAD in its latest WIR identified close to 15,000 SOEs, with more than 86,000 foreign affiliates operating around the world.<sup>46</sup> More importantly, although the number of SOEs represents only 1.5 per cent of the universe of multinational enterprises, the value of their FDI has reached about 11 per cent of global FDI flows (Figure 1.7).<sup>47</sup> As global investors, SOEs are active in both greenfield investments and cross-border merger and acquisition (M&A) purchases.<sup>48</sup> FDI by SOEs increased dramatically during the global financial crisis that began in 2008. Over the period between 2010 and 2016, the total value of their announced projects reached \$514 billion.<sup>49</sup> In addition, the value of SOEs' outward M&As spiked at the outset of the financial crisis (between 2008 and 2010). Today, international M&As by SOEs still make up about 30 per cent of all M&A activities (Figure 1.8).<sup>50</sup>

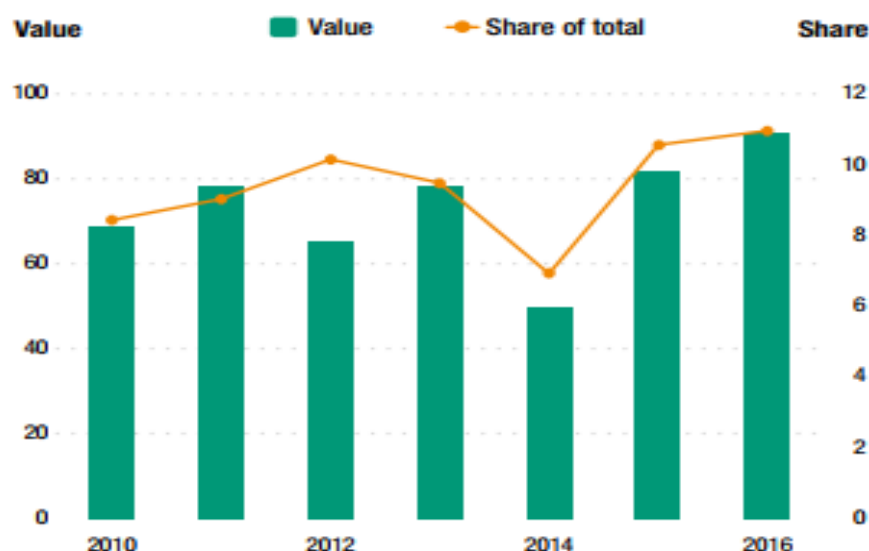


Figure 1.7 Announced greenfield FDI projects by SO-MNEs, value and share of total, 2010-2016 (Billions of dollars and per cent)

Source: UNCTAD, *WIR 2017*, based on information from the Financial Times Ltd, fDi Markets <[www.fDimarkets.com](http://www.fDimarkets.com)>

the universe of multinational enterprises, their share of the world's largest non-financial multinational enterprises in 2015 was 10 times higher, UNCTAD, *WIR 2017* (n 2) 32.

<sup>46</sup> *ibid* 30.

<sup>47</sup> *ibid* 37. FDI by SOEs has grown rapidly since 2000, and the amount reached a peak in 2008 with \$149 billion of announced greenfield investments and \$109 billion cross-border M&As, UNCTAD, *WIR 2015* (n 18) 17.

<sup>48</sup> UNCTAD, *WIR 2011* (n 3) 32.

<sup>49</sup> UNCTAD, *WIR 2017* (n 2) 38.

<sup>50</sup> OECD, *State-Owned Enterprises as Global Competitors: A Challenge or An Opportunity?* (n 37) 30.

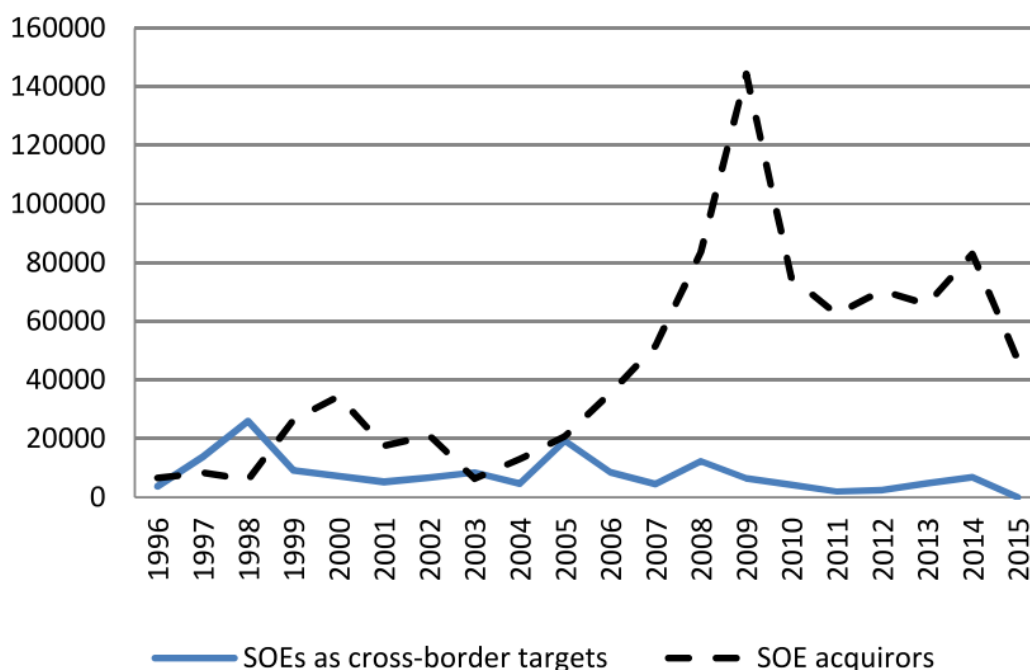


Figure 1.8 SOEs as targets and acquirer of international M&A by deal value, 1996-2015 (Millions of dollars)

Source: OECD, *State-Owned Enterprises as Global Competitors: A Challenge or An Opportunity* (2016), 51

Note: SOEs here are only wholly-state owned enterprises

There are two prominent characteristics of the current global expansion of SOEs. Firstly, most SOEs are from developing economies, especially China, Malaysia, India, the Russian Federation and the United Arab Emirates (UAE). EU member states also have a considerable number of SOEs, especially Sweden, France and Italy (Figure 1.9).<sup>51</sup> Based on the 2015 Forbes 2000 Global ranking of companies, 128 of the world's largest SOEs in 2014 are based in mainland China, and an additional 13 domiciled in Hong Kong (China), with OECD countries accounting for 33 largest SOEs.<sup>52</sup>

<sup>51</sup> According to the UNCTAD's new database, more than half of SOEs worldwide are from developing economies, especially China (257), Malaysia (79), India (61), the Russian Federation (51) and UAE (50), while close to two fifths are from developed countries especially EU member states, UNCTAD, *WIR 2017* (n 2) 31. Based on the 2015 Forbes 2000 Global ranking of companies, 128 of the world's largest SOEs in 2014 were headquartered in Mainland China. Moreover, compared with SOEs from developed countries, SOEs from emerging economies have been more active in investing abroad which have contributed significantly to the growth of FDI flows, UNCTAD, *World Investment Report 2014 - Investing in the SDGs: An Action Plan* (UN Publication 2014) 22.

<sup>52</sup> In addition, among the world's largest companies, 34 SOEs from India, 29 SOEs from the Middle Eastern countries, 10 from Russia and 7 from Brazil, OECD, *State-Owned Enterprises as Global Competitors: A Challenge or An Opportunity?* (n 37) 21.

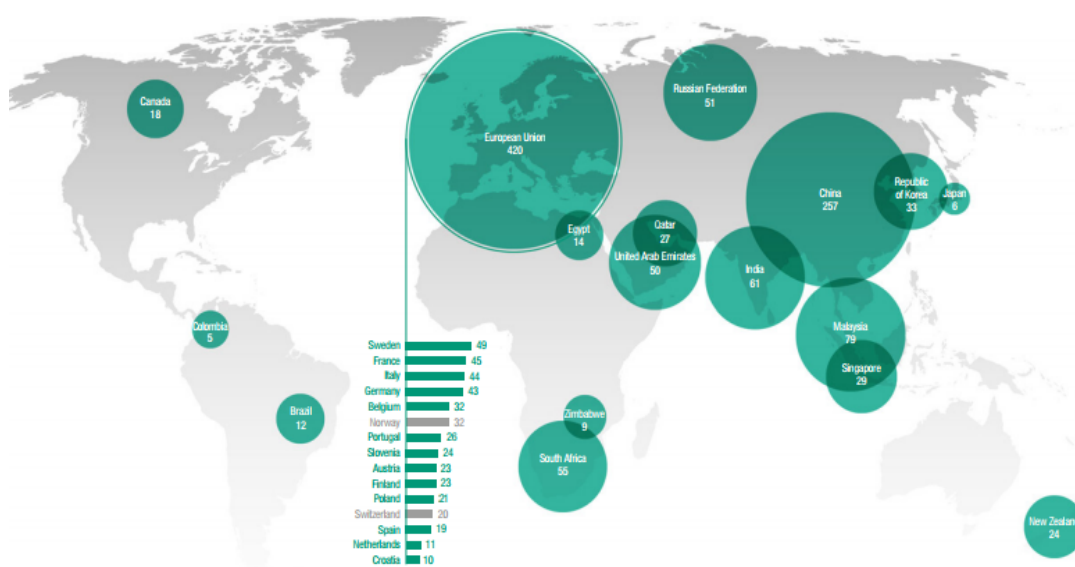


Figure 1.9 SO-MNEs: Distribution by major home economy, 2017 (Number of companies)

Source: UNCTAD, *WIR 2017*, based on information from UNCTAD's SO-MNE database

<[www.unctad.org/fdistatistics](http://www.unctad.org/fdistatistics)>

Note: Grey bars indicate European countries that are not members of the EU

In terms of SOE investments, it is interesting to note that developing countries normally play the role of home states while developed countries mainly act as host states. During 2003-2010, 56 per cent of global outward FDI came from developing and transition economies.<sup>53</sup> In 2015, the value of international M&A by SOEs from emerging economies was about \$58,000 million, while that from developed economies was about \$16,000 million.<sup>54</sup> Geographically, in 2017, the EU was host to almost 33,000 (38 per cent) of the more than 86,000 SOEs foreign affiliations, while the top individual host countries around the world are the US (close to 9,000), the UK (close to 8,000) and Germany (close to 5,000) (Figure 1.10).<sup>55</sup> In addition, empirical studies indicate that SOEs from both Asia and Europe focus heavily on the EU market, followed by the US and a few emerging economies. To some extent, SOEs from European countries are more regional, whereas SOEs from Asia appear more globalised.<sup>56</sup>

<sup>53</sup> UNCTAD, *WIR 2011* (n 3) 32.

<sup>54</sup> OECD, *State-Owned Enterprises as Global Competitors: A Challenge or An Opportunity?* (n 37) 52.

<sup>55</sup> UNCTAD, *WIR 2017* (n 2) 32.

<sup>56</sup> *ibid* 35.

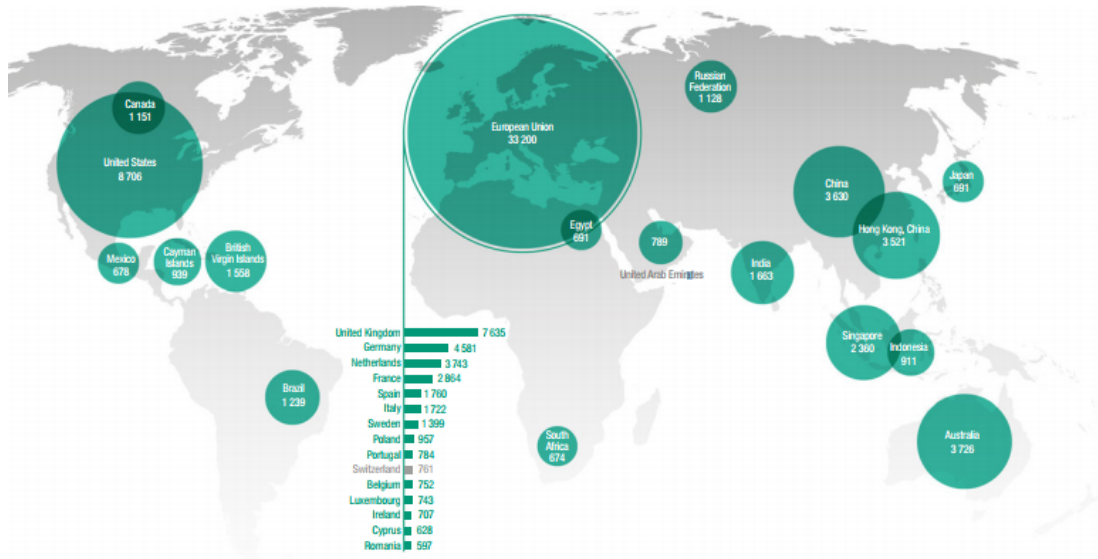


Figure 1.10 Foreign affiliates of SO-MNEs: Distribution by major host economy, 2017  
(Number of affiliates)

Source: UNCTAD, *WIR 2017*, based on information from UNCTAD's SO-MNE database  
<[www.unctad.org/fdistatistics](http://www.unctad.org/fdistatistics)>

Note: Grey bars indicate European countries that are not members of the EU

Secondly, the global presence of SOEs is considerable in critical sectors or so-called 'strategic industries', including financial services, infrastructures and natural resources (Figure 1.11).<sup>57</sup> During 2010-2016, for instance, greenfield projects by SOEs in utilities, and in automotive and transportation sectors together accounted for close to 60 per cent of the cumulative value of announced projects; meanwhile, most of the international M&As by SOEs focused on telecommunication, electricity and transport services.<sup>58</sup> In fact, over half of SOEs are concentrated in sectors of financial service and natural resource, reflecting that state owners wish to control more directly key resources and key infrastructure networks.<sup>59</sup> For example, more than three-fourths of global crude oil reserves are controlled by SOEs, some of which are from developing states including CNPC, Sinopec and CNOOC in China, Gazprom in the Russian Federation, Petronas in Malaysia, Petrobras in Brazil and Saudi Aramco in Saudi Arabia.<sup>60</sup>

<sup>57</sup> OECD, *State-Owned Enterprises as Global Competitors: A Challenge or An Opportunity?* (n 37) 21; UNCTAD, *WIR 2014* (n 51) 21; UNCTAD, *WIR 2017* (n 2) 38.

<sup>58</sup> *ibid* 38.

<sup>59</sup> *ibid*.

<sup>60</sup> UNCTAD, *WIR 2014* (n 51) 21.



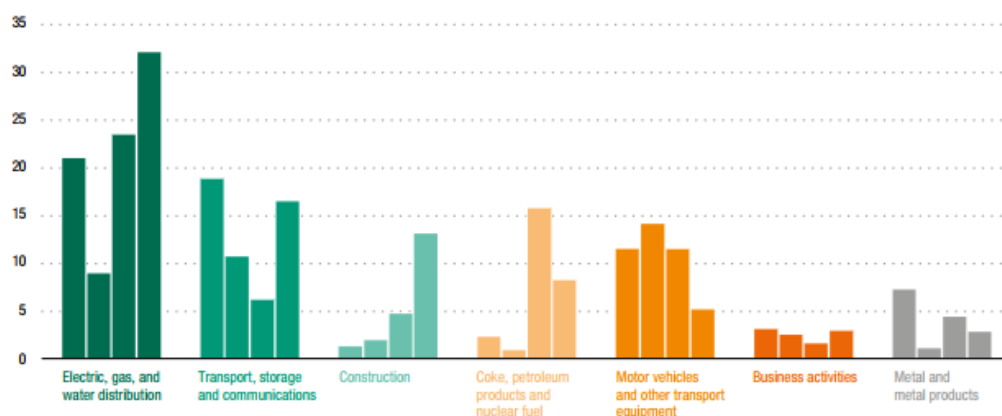


Figure 1.11 Value of announced greenfield FDI projects by SO-MNEs, by sector and industry, 2013-2016 (Billions of dollars)

Source: UNCTAD, *WIR 2017*, based on information from the Financial Times Ltd, fDi Markets <[www.fDimarkets.com](http://www.fDimarkets.com)>

### 1.3.2 Concerns and Policy Responses in Relation to Cross-Border SOEs

The global expansion of SOEs from emerging economies and developing states - dubbed by some commentators as a (re-)emergence of ‘state capitalism’ - has met with rising doubts and critical reactions.<sup>61</sup> The *Economist* once stated that ‘the rise of state capitalism - the spread of a new sort of business in the emerging world will cause increasing problems’.<sup>62</sup> While Western countries as host states have generally welcomed the inward SOE investments as an important source of capital and finance, especially after the recent economic crisis, they have also raised a broad range of

<sup>61</sup> Kowalski and Perepechay (n 37) 7. ‘State capitalism’ is not new, but it has undergone resurgence over the past three decades. Despite its widespread use, there is no unitary definition of the term. According to Ian Bremmer, ‘state capitalism’ is a form of capitalism where the state functions as the leading economic actor and uses markets primarily for political gain. In this system, state-owned enterprise, selected privately owned companies and sovereign wealth funds are important vehicles for states to exercise influence in the market. In particular, China has been argued as a typical example of state capitalism in the 21<sup>st</sup> century. Ian Bremmer, *The End of the Free Market* (Portfolio 2010) 4–5; Editorial, ‘The Special Report on “The Rise of State Capitalism”’ *The Economist* (21 Jan 2012) <<http://www.economist.com/node/21543160>> accessed 12 September 2017; Ming Du, ‘China’s State Capitalism and World Trade Law’ (2014) 63 *International and Comparative Law Quarterly* 409, 410. See more, generally, e.g., Aldo Musacchio and Sergio G Lazzarini, ‘Leviathan in Business: Varieties of State Capitalism and Their Implications for Economic Performance’ (2012); Curtis J Milhaupt and Wentong Zheng, ‘Beyond Ownership: State Capitalism and the Chinese Firm’ (2015) 103 *The Georgetown Law Journal* 665; Li-Wen Lin and Curtis J Milhaupt, ‘We Are the (National) Champions: Understanding the Mechanisms of State Capitalism in China’ (2013) 65 *Standard Law Review* 697; Andrew Szamosszegi and Cole Kyle, ‘An Analysis of State-owned Enterprises and State Capitalism in China’ (US-China Economic and Security Review Commission 2011) <[https://www.uscc.gov/sites/default/files/Research/10\\_26\\_11\\_CapitalTradeSOEStudy.pdf](https://www.uscc.gov/sites/default/files/Research/10_26_11_CapitalTradeSOEStudy.pdf)> accessed 12 September 2017.

<sup>62</sup> ‘The Special Report on “The Rise of State Capitalism”’ (n 61).

concerns over foreign SOEs in relation to national security, competitive neutrality, corporate governance and transparency.<sup>63</sup>

From an investment perspective, a primary concern is that SOE investments may be driven by non-commercial objectives - especially in critical and strategic sectors - that might have detrimental impacts on national security or other vital interests of the receipt country.<sup>64</sup> In 2006, for example, the US Congress overturned a deal by the UAE state-owned company, Dubai Ports World (DPW), for acquiring five US port terminal facilities on the ground of national security considerations.<sup>65</sup> In the CNOOC-Unocal deal, Chinese SOE investment was described as a ‘Trojan horse’ of Chinese values and politics that would imperil the national security of the US because it would enable China to access sensitive technology and information, to control the vital energy assets of the US and to facilitate Chinese strategic policy.<sup>66</sup>

Moreover, as SOEs expand into the global marketplace, some advantages granted to SOEs by the (home) government may create anti-competitive effects in the global marketplace.<sup>67</sup> For instance, SOEs may enjoy preferential access to finance or preferable regulatory treatment which put their private-sector counterparts at a competitive disadvantage. A relevant concept here is ‘competitive neutrality’ (CN), which concerns the maintenance of a level playing field between public and private

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<sup>63</sup> UNCTAD, *WIR 2017* (n 2) 37; UNCTAD, *WIR 2011* (n 3) 36–7; Sauvant, Sachs and Jongbloed (n 3) 10–2; Wang and Gallagher (n 3) 1.

<sup>64</sup> UNCTAD, *WIR 2011* (n 3) 36; Graham Mott and Wan Khatina Nawawi, ‘SOE Provisions in International Agreements’ in Deborah Healey (ed), *Competitive Neutrality and Its Application in Selected Developing Countries* (UNCTAD 2014) 290; OECD, *State-Owned Enterprises as Global Competitors: A Challenge or An Opportunity?* (n 37) 34; Michael Gestrin and others, ‘Governments as Competitors in the Global Marketplace: Options for Ensuring a Level Playing Field’ (ICTSD and World Economic Forum 2016) E15 Initiative 4 <<http://e15initiative.org/publications/governments-as-competitors-in-the-global-marketplace-options-for-ensuring-a-level-playing-field/>> accessed 12 September 2017.

<sup>65</sup> Edward Alden, Stephanie Kirchgaessner and Demetri Sevastopulo, ‘Dubai cedes control in US ports battle’ *Financial Times* (Washington, 10 Mar 2006) <[http://www.ft.com/cms/s/0/325d3dcc-af99-11da-b417-0000779e2340.html?ft\\_site=falcon&desktop=true#axzz4oPLt6ixX](http://www.ft.com/cms/s/0/325d3dcc-af99-11da-b417-0000779e2340.html?ft_site=falcon&desktop=true#axzz4oPLt6ixX)> accessed 12 September 2017.

<sup>66</sup> See Ming Du, ‘When China’s National Champions Go Global: Nothing to Fear but Fear Itself’ (2014) 48 *Journal of World Trade* 1127; Sophie Meunier, ‘Economic Patriotism: Dealing with Chinese Direct Investment in the United States’ [2012] *Columbia FDI Perspectives* <<https://doi.org/10.7916/D8CV4RZ7>> accessed 12 September 2017; OECD, ‘SOEs Operating Abroad: An Application of the OECD Guidelines on Corporate Governance of State-Owned Enterprises to the Cross-Border Operations of SOEs’ <<https://www.oecd.org/daf/ca/corporategovernanceofstate-ownedenterprises/44215438.pdf>> accessed 12 September 2017.

<sup>67</sup> OECD, *State-Owned Enterprises as Global Competitors: A Challenge or An Opportunity?* (n 37) 30.

businesses.<sup>68</sup> Although CN is not a new concept in domestic competition law, it has become the subject of a heated international debate in recent years.<sup>69</sup> In 2011, the then US Under Secretary Robert Hormats argued that ‘now is the key moment to focus on competitive neutrality and attempt to re-level the playing field for US and other global companies’.<sup>70</sup> His reasoning was that state-owned enterprise, and state-supported enterprises or ‘National Champions’ as serious global competitors ‘are using a multitude of advantages gained at home’ and ‘may have unfair competitive advantages in the US or third countries’.<sup>71</sup>

The root cause of above fears about SOEs is their political nature, i.e., their close ties to the government. As mentioned earlier, the state-owned nature makes SOEs unique from private-owned firms. The government can not only establish SOEs by state capital but also appoint state officials as board members when it is a controlling owner. Moreover, SOEs may focus on political objectives and strategies of the government over economic objectives. This may present a risk of SOEs becoming less independent in their decisions or even used for political purposes. As a result, some has considered SOEs as the agent of their (home) government. Although the marriage of state ownership and market systems on a global scale sparks heated debates, no one can deny the close affiliation of SOEs to the government.

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<sup>68</sup> See e.g., Antonio Capobianco and Hans Christiansen, ‘Competitive Neutrality and State-Owned Enterprises: Challenges and Policy Options’ (OECD 2011) 1 <<http://dx.doi.org/10.1787/5kg9xfjdhg6-en>> accessed 12 September 2017; Karl P Sauvart and others, ‘Trends in FDI, Home Country Measures and Competitive Neutrality’ in Andrea K Bjorklund (ed), *Yearbook on International Investment Law & Policy 2012-2013* (OUP 2014).

<sup>69</sup> The concept of competitive neutrality can be traced back to the National Competition Policy of Australia in 1993. To address CN concerns, Australia has established a comprehensive competitive neutrality framework that can effectively address CN problems *ex ante*. In contrast, some countries are using remedies to deal with CN problems *ex post*, i.e., applying competition law to require public sector businesses to cease actions that have a detrimental impact on the competition - a typical example is Article 106 TFEU (*ex* Article 86 TEC). For more discussion see Matthew Rennie and Fiona Lindsay, ‘Competitive Neutrality and State-Owned Enterprises in Australia: Review of Practices and Their Relevance for Other Countries’ (OECD 2011) 4 <<http://dx.doi.org/10.1787/5kg54cxkxm36-en>> accessed 12 September 2017; OECD, ‘State-Owned Enterprises and the Principle of Competitive Neutrality’ (2009) DAF/COMP(2009)37 <<http://www.oecd.org/daf/competition/46734249.pdf>> accessed 12 September 2017.

<sup>70</sup> Robert D Hormats, ‘Ensuring a Sound Basis for Global Competition: Competitive Neutrality’ *DIPNOTE-US Department of State Official Blog* (6 May 2011) <<https://blogs.state.gov/stories/2011/05/06/ensuring-sound-basis-global-competition-competitive-neutrality>> accessed 14 October 2016.

<sup>71</sup> *ibid.*

It is notable, however, that increasing concerns over SOE investments are mostly suspicions, not evidenced by any significant number of actual conflicts in practice. Consequently these suspicions fuel policy debates.<sup>72</sup> For example, it is unclear whether and to what extent SOEs do put private multinational enterprise at a competitive disadvantage; and it is problematic whether and to what extent the possible ‘undue’ advantages for SOEs could have beggar-thy-neighbour or internationally negative effects.<sup>73</sup> More basically, whether SOE investment is driven by commercial or public policy objectives is a very controversial issue and there is no clear division between the two. While some assume that SOEs and their home governments are identical in respect of strategic motivations for investment, further political economic analysis suggests that there exist gaps between governments and SOEs in relation to motives for outward investments; and motives of an SOE investing overseas are case-specific.<sup>74</sup> For example, the primary motivation for some Indian SOEs to invest overseas is arguably to gain more resource independence from other state actors at home.<sup>75</sup> In the case of Chinese SOEs, some argue that their global expansion does not always accord with governmental interests, but is primarily driven by domestic competition pressures and independent expectations on profits. A 2014 OECD survey identified that the primary motivations of Chinese SOEs for overseas expansion include: ‘better allocating resources globally; acquiring advanced technologies and management experience; and integrating the company’s product line and catering for the Chinese domestic market’.<sup>76</sup>

Nonetheless, fears have prompted some Western countries to take regulatory measures to address their concerns over SOEs. At the domestic level, some countries such as Australia, Canada and the US have tightened their screenings of FDI

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<sup>72</sup> Michael V. Gestrin, ‘State-owned Enterprises Finding Bigger Role in Global Investment’ *East Asia Forum* (27 November 2014) <<http://www.eastasiaforum.org/2014/11/27/state-owned-enterprises-finding-bigger-role-in-global-investment/>> accessed 12 September 2017.

<sup>73</sup> At least, until now, empirical work and economic studies have been unable to reach a definite answer, see OECD, *State-Owned Enterprises as Global Competitors: A Challenge or An Opportunity?* (n 37) 15, 59.

<sup>74</sup> *ibid* 53. See also Sanja Tepavcevic, ‘The Motives of Russian State-Owned Companies for Outward Foreign Direct Investment and Its Impact on State-Company Cooperation: Observations Concerning the Energy Sector’ 23 *Transnational Corporations* 29, 29–54. (The case study of three outward investments by Russian SOEs suggests that despite usually being portrayed as channeled for Russian political influence, ‘the primary drivers for outward FDI by Russian state-owned companies are their business interests’.)

<sup>75</sup> OECD, *State-Owned Enterprises as Global Competitors: A Challenge or An Opportunity?* (n 37) 53.

<sup>76</sup> *ibid* 54.

(especially M&A) for foreign SOEs.<sup>77</sup> At the international level, the US has proposed the use of bilateral, regional and multilateral trade and investment policy tools in responding to the important challenges of ‘state capitalism’ to the US and global economy.<sup>78</sup> Indeed, the WTO law has already provided several disciplines on anti-competitive activities of state enterprises, although regulatory gaps and uncertainties still exist.<sup>79</sup> Moreover, an increasing number of bilateral and regional treaties have covered SOEs or attempted to include SOE disciplines, including the Chinese BIT talks with the US and the EU, and the TPP and the TTIP.<sup>80</sup> In particular, the newly concluded TPP includes an entire chapter on SOEs in support of a level playing field between SOEs and private investors, which may have implications for future BIT and FTA negotiations.<sup>81</sup>

### 1.3.3 Problems for the Investment Law Regime Posed by SOEs

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<sup>77</sup> For instance, the DPW case also prompted US Congress to pass the Foreign Investment and National Security Act of 2007 (FINSA) which clarifies that SOEs fall within the scope of national security considerations, see Przemyslaw Kowalski and others, ‘State-Owned Enterprises: Trade Effects and Policy Implications’ (2013) 147 37; Yuri Shima, ‘The Policy Landscape for International Investment by Government-Controlled Investors: A Fact Finding Survey’ (OECD 2015) 2015/01 <<http://dx.doi.org/10.1787/5js7svp0jkns-en%0AOECD>> accessed 12 September 2017; OECD, *State-Owned Enterprises as Global Competitors: A Challenge or An Opportunity?* (n 37) 86–7. For more discussion see Chapter 3.

<sup>78</sup> The US Under-Secretary of State, Robert Hormats, argued that ‘now is the key moment to focus on competitive neutrality and to re-level the playing field of US and other global companies’ because ‘state-owned enterprise, and state-supported enterprises or “National Champions” are emerging to become serious global competitors’, see Hormats (n 70).

<sup>79</sup> See e.g., Du, ‘China’s State Capitalism and World Trade Law’ (n 61) 409; Kowalski and others, ‘State-Owned Enterprises: Trade Effects and Policy Implications’ (n 77) 27–9; Gestrin and others (n 61) 11.

<sup>80</sup> For example, a few BITs expressly include SOEs in the definition of ‘investors’, see also Ch 2. For the Chinese BIT negotiations with the US and the EU, see e.g., Lauren Gloudeman and Nargiza Salidjanova, ‘Policy Considerations for Negotiating a US-China Bilateral Investment Treaty’ (Economic and Security Review Commission Staff Research Report 2016) <<https://www.uscc.gov/Research/policy-considerations-negotiating-us-china-bilateral-investment-treaty>> accessed 12 September 2017; Axel Berger, ‘The Case for An EU-China Investment Treaty’ (DIE 2014) <<https://www.die-gdi.de/en/the-current-column/article/the-case-for-an-eu-china-investment-treaty/>> accessed 12 September 2017. For a text of TPP rules on SOEs see <<https://ustr.gov/sites/default/files/TPP-Final-Text-State-Owned-Enterprises-and-Designated-Monopolies.pdf>> accessed 12 September 2017; for SOE rules in the TTIP, see EU’s initial proposal for legal text on SOEs in TTIP <[http://trade.ec.europa.eu/doclib/docs/2015/january/tradoc\\_153030.pdf](http://trade.ec.europa.eu/doclib/docs/2015/january/tradoc_153030.pdf)> (7 January 2015) accessed 12 September 2017.

<sup>81</sup> For more discussion see e.g., Sean Miner, ‘Commitments on State-Owned Enterprises’ in Cathleen Cimino-Isaacs and Jeffrey J Schott (eds), *Trans-Pacific Partnership: An Assessment* (Peterson Institute For International Economics 2016) 335–48; Ines Willemyns, ‘Disciplines on State-Owned Enterprises in International Economic Law: Are We Moving in the Right Direction?’ (2016) 19 *Journal of International Economic Law* 657.

It has been recognised that the upsurge of SOE investments from developing countries challenges the investment law regime. The state is playing a triple role in global investment - it has become an active global investor in addition to its previous roles as a regulator of foreign investments and a rule-maker of IIAs. As a result, the growing role of SOEs in economic life has complicated existing tensions between foreign investors and host states as well as home states and host states, whilst intensifying policy divergences in the investment law regime. For example, a question arises whether or not SOEs should be protected by international investment treaties which were originally intended to protect and promote private investment. A further concern is whether or not SOE investors should be excluded from ISDS because they are already privileged in home states or backed by their home governments.

Indeed, policy concerns and responses for SOEs reflect only one facet in which the landscape of international investment is changing and the regime of international investment law and policy continues to evolve. It is recognised that investment treaty programmes were originally designed by advanced capital-exporting states (i.e., developed countries) after the Second World War to protect their investors and investments against potential political risks, especially nationalisation and expropriation, in host states (i.e., developing countries) under treaties and customary international law and by a ‘depoliticised’ investment arbitration mechanism.<sup>82</sup> However, with the growth of FDI outflows from developing countries such as China, both developed and developing countries now see themselves not just as home states but also as host states in investment treaty negotiations. As a result, the gap between

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<sup>82</sup> As noted by some scholars, the objective of IIA programs designed by developed countries was not just to protect individual investors but also to develop customary international law on foreign investment. In fact, it was part of a reaction from the developed countries to the New International Economic Order (NIEO) movement that was crystallised by the adoption of UN General Assembly Resolution 1803 (Permanent Sovereign over Natural Resources, adopted in 1962) and Resolution 3281 (Charter of Economic Rights and Duties of States, adopted in 1974) that essentially denied the legitimacy of an international minimum standard under customary international law espoused by developed countries, especially concerning the Hull rule on compensation for expropriation. See e.g., Kenneth J Vandevelde, ‘A Brief History of International Investment Agreements’ (2005) 12 U.C. Davis Journal of International Law & Policy 157, 157; Vandevelde, *U.S. International Investment Agreements* (n 18) 1; Bonnitche, Poulsen and Waibel (n 14) 193–200; Wenhua Shan, ‘Toward a Multilateral or Plurilateral Framework on Investment’ (ICTSD & World Economic Forum 2015) E15 Initiative 5  
<<http://e15initiative.org/publications/toward-a-multilateral-or-plurilateral-framework-on-investment/>> accessed 12 September 2017.

developed and developing countries - also called the ‘North-South’ divide - in the old IIA regime became blurred. Instead, the theme of international investment law in new realities has shifted to strike a balance of rights and obligations between foreign investors and host states, i.e., the ‘Private-Public’ debate.<sup>83</sup>

With the emergence of measures tailored to regulate SOE investments, it seems a third dimension, namely the ‘East-West’ contest, is surfacing in international investment law. It is termed as the ‘East-West’ contest because it primarily touches upon the investment relationship between the emerging economic powers from the East (such as China and Russia) on the one hand, and on the other, traditional advanced economic powers from the West. More fundamentally, it represents a contest between two models of economic development. One is the traditional Western model of ‘laissez faire’ free market economy emphasising the ‘invisible hand of the market’, or market capitalism. The other is an economy that emphasises the ‘visible hand of the state’, or state capitalism.<sup>84</sup>

Like the existing ‘North-South’ and ‘Private-Public’ dimensions of international investment law regime, the emerging ‘East-West’ dimension demonstrates a further layer of tensions in the international investment relationship. Whilst the ‘Private-Public’ dimension focuses on the direct relationship of the two key players, namely, the investor and the host state, the ‘East-West’ dimension like the ‘North-South’ dimension focuses on the indirect relationship between the host and home states of foreign investment. However, the ‘East-West’ dimension also differs from the ‘North-South’ dimension in terms of the focus of its concerns: whilst the ‘North-South’ conflict has focused on the establishment of an international minimum

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<sup>83</sup> Wenhua Shan, ‘The Protection of Foreign Investment’ in Karen B Brown and David V. Snyder (eds), *General Reports of the XVIIIth Congress of the International Academy of Comparative Law* (Springer 2012) 504; Bonnitcha, Poulsen and Waibel (n 14) 8–30.

<sup>84</sup> For more discussion of the two models see Erik S Reinert, ‘The Role of the States in Economic Growth’ in Pier Angelo Toninelli (ed), *The Rise and Fall of State-Owned Enterprise in the Western World* (CUP 2011); Deng Feng, ‘Indigenous Evolution of SOE Regulation’ in Benjamin L Liebman and Curtis J Milhaupt (eds), *Regulating the Visible Hand?: The Institutional Implications of Chinese State Capitalism* (OUP 2015); Bremmer (n 61); Subitha Subramaniam, ‘The Rise of the Visible Hand in Economic Policy’ *Financial Times* (3 May 2015) <<https://www.ft.com/content/408379fc-edb0-11e4-987e-00144feab7de>> accessed 26 August 2017; ‘The Special Report on “The Rise of State Capitalism”’ (n 61); Niall Ferguson, ‘We’re All State Capitalists Now’ *Foreign Policy* (9 Feb 2012) <<http://foreignpolicy.com/2012/02/09/were-all-state-capitalists-now/>> accessed 12 September 2017.

standard of foreign investment protection, its ‘East-West’ counterpart focuses on whether and to what extent the same international minimum standard of protection afforded to private foreign investment is equally extended to cover SOE investments.

Given the significance of SOE investments in world investments as highlighted above, the new ‘East-West’ dimension of international investment law merits a thorough and comprehensive investigation. The question today is neither whether state should play a role in economic life, nor whether state capitalism is better or worse vis-à-vis market capitalism. Rather, the real problem is how to regulate SOE investments in order to achieve a proper balance of rights and obligations between foreign investors - whether privately or publicly owned - and host states.

## 1.4 Existing Literature Review

As stated earlier, SOEs are relatively new actors in the international investment law and policy regime. Before the twentieth century, both international investment treaties and associated materials seldom referred to SOEs. An exception is the US. As noted by Vandevelde, US BIT negotiators in the early 1990s had provided SOE provisions in some of its BITs which typically provided a definition, application and non-discriminatory treatment.<sup>85</sup> However, the aim of including SOEs in BITs, as argued by Vandevelde, was ‘to ensure that state enterprises were not used to circumvent BIT obligations’,<sup>86</sup> rather than to protect SOEs investing abroad. For a long time, discussions surrounding SOEs in the context of international law focus on whether states are responsible for SOE conducts. As will be shown in Chapter 2, some arbitral tribunals have relied on the International Law Commission’s Articles (ILC Articles) on Responsibility of States for Internationally Wrongful Acts to decide whether action of SOEs could be attributed to the state.<sup>87</sup> Another relevant

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<sup>85</sup> The US negotiators drafted a uniform provision that appears at Article II (2) of seven BITs- with Moldova, Ecuador, Belarus, Ukraine, Estonia, Latvia, and Lithuania- that were based on the 1992 model, and the 1994 and 2004 model included successors to the seven BITs, Vandevelde, *U.S. International Investment Agreements* (n 18) 458.

<sup>86</sup> *ibid.*

<sup>87</sup> *Maffezini v. Spain*, Award on Jurisdiction, 25 Jan 2000 (ICSID Case No. ARB/97/7), para 75. For more discussion see e.g., Michael Feit, ‘Responsibility of the State under International Law for the Breach of Contract Committed by a State-Owned Entity’ (2010) 28 Berkeley Journal of International Law 142; Kaj Hobér, ‘State



legal issue is whether SOEs enjoy state immunity from foreign jurisdictions.<sup>88</sup> Today, discussions on these two issues still play a role in the literature of SOEs.

Since 2000, a growing number of government officials and scholars from both developed and developing worlds have been debating about concerns and policy options relating to SOEs. The OECD is the most active organisation that has conducted research on a wide range of issues of SOEs, especially the corporate governance and competition impacts of SOEs. For example, the OECD in 2005 adopted guidelines on corporate governance of SOEs (new edition updated in 2015) to help governments assess and improve the way they exercise their ownership functions in SOEs.<sup>89</sup> Furthermore, the OECD has taken stock of national trends in state ownership practices to identify good practices and support effective implementation of the OECD Guidelines on Corporate Governance of SOEs.<sup>90</sup>

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Responsibility and Attribution' in Peter Muchlinski, Federico Ortino and Christoph Schreuer (eds), *The Oxford Handbook of International Investment Law* (OUP 2008); Simon Olleson, 'Attribution in Investment Treaty Arbitration' (2016) 31 ICSID Review - Foreign Investment Law Journal 457; Eduardo Silva Romero, 'Are States Liable for the Conduct of Their Instrumentalities? ICC Case Law' in Emmanuel Gaillard and Jennifer Younan (eds), *State Entities in International Arbitration* (Juris Publishing 2008).

<sup>88</sup> See, generally, e.g., David Gaukrodger, 'Foreign State Immunity and Foreign Government Controlled Investor' (2010) OECD Working Papers on International Investment 2010/2 <doi: 10.1787/5km91p0ksqs7-en> accessed 11 September 2017; Leon Chung, 'Recent Trends in State Immunity' (*Kluwer Arbitration Blog*, 2013) <<http://kluwerarbitrationblog.com/2013/04/25/recent-trends-in-state-immunity/>> accessed 11 September 2017; AFM Maniruzzaman, 'State Enterprise, Arbitration and Sovereign Immunity Issues: A Look at Recent Trends' (2005) 69 *Dispute Resolution Journal* 77; Emmanuel Gaillard, 'Effectiveness of Arbitral Awards, State Immunity from Execution and Autonomy of State Entities: Three Incompatible Principles' in Emmanuel Gaillard and Jennifer Younan (eds), *State Entities in International Arbitration* (Juris Publishing 2008).

<sup>89</sup> OECD, *OECD Guidelines on Corporate Governance of State-Owned Enterprises* (n 40). See also OECD, 'State-Owned Enterprise Governance Reform: An Inventory of Recent Change' 56 <<http://www.oecd.org/daf/ca/corporategovernanceofstate-ownedenterprises/48455108.pdf>> accessed 11 September 2017.

<sup>90</sup> The research covers a broad range of issues in relation to corporate governance, including boards of directors of SOEs, risk management, rationales for state ownership, disclosure and transparency. See e.g., OECD, *Boards of Directors of State-Owned Enterprises: An Overview of National Practices* (OECD Publishing 2013); OECD, *Risk Management by State-Owned Enterprises and Their Ownership* (OECD Publishing 2016); OECD, *State-Owned Enterprise Governance. A Stocktaking of Government Rationales for Enterprise Ownership* (OECD Publishing 2015); Korin Kane and Hans Christiansen, 'State-Owned Enterprises: Good Governance as a Facilitator for Development' [2015] *Coherence for Development*; OECD, *State-Owned Enterprises in the Development Process* (OECD Publishing 2015); OECD, *Accountability and Transparency: A Guide for State Ownership* (OECD Publishing 2010); OECD, *The Role of Institutional Investors in Promoting Good Corporate Governance* (OECD Publishing 2011). Moreover, some research has adopted comparative studies to evaluate the national practice on corporate governance, see e.g., OECD, *State-Owned Enterprises in Asia: National Practices for Performance Evaluation and Management* (OECD Publishing 2016); OECD, *Broadening the Ownership of State-Owned Enterprises: A Comparison of Governance Practices* (OECD Publishing 2016); OECD, *The Size and Sectoral Distribution of SOEs in OECD and Partner Countries* (OECD Publishing 2014).

With SOEs having come to play a more important role as investors after the 2008 financial crisis, some Western countries have expressed concerns regarding the ‘competitive neutrality’ of SOEs. In 2012, the US and the EU issued a Statement on Shared Principles for International Investment and reaffirmed their shared commitments on maintaining open, transparent and non-discriminatory investment climates.<sup>91</sup> In this Statement, both the EU and the US have committed to the principle of ‘a level playing field’ and support the work of the OECD in the area of competitive neutrality.<sup>92</sup> In fact, the OECD has engaged in multiple projects on competitive neutrality since 2009 and has published a series of reports to identify the concerns and challenges of SOEs in the marketplace.<sup>93</sup> The OECD has conducted many empirical studies to identify the importance of SOEs in the marketplace and to explore the various national approaches to competitive neutrality.<sup>94</sup> As noted by the OECD, international trade and investment by SOEs is likely to increase, creating competition challenges and policy issues both in their domestic economies and international market place.<sup>95</sup> According to the OECD, both national and international policy instruments can be used to address anti-competitive cross-border effects of SOEs, including the OECD SOE Guidelines, national competitive neutrality frameworks, national competition laws, the WTO agreements, preferential trade

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<sup>91</sup> ‘Statement of the European Union and the United States on Shared Principles for International Investment’ (2012) <[http://trade.ec.europa.eu/doclib/docs/2012/april/tradoc\\_149331.pdf](http://trade.ec.europa.eu/doclib/docs/2012/april/tradoc_149331.pdf)> accessed 11 September 2017.

<sup>92</sup> *ibid.*

<sup>93</sup> See e.g., OECD, ‘State-Owned Enterprises and the Principle of Competitive Neutrality’ (2009) DAF/COMP(2009)37 <<http://www.oecd.org/daf/competition/46734249.pdf>>; Capobianco and Christiansen (n 68); Rennie and Lindsay (n 69); OECD, *Competitive Neutrality: Maintaining a Level Playing Field between Public and Private Business* (OECD Publishing 2012); OECD, ‘Maintaining A Level Playing Field Between Public and Private Business for Growth and Development: Background Report’ (2013); Hans Christiansen, ‘Balancing Commercial and Non- Commercial Priorities of State-Owned Enterprises’ (2013) 6 <<http://dx.doi.org/10.1787/5k4dkhztkp9r-en%0AOECD>>; OECD, ‘Levelling the International Playing Field Between Public and Private Business: What Have We Learnt So Far?’ (2014) <[http://www.oecd.org/corporate/C-MIN\(2014\)20-ENG.pdf](http://www.oecd.org/corporate/C-MIN(2014)20-ENG.pdf)>; Hans Christiansen and Yunhen Kim, ‘State-Invested Enterprises in the Global Marketplace: Implications for a Level Playing Field’ (2014) 14 <<http://dx.doi.org/10.1787/5jz0xvfv16nw-en%0AOECD>>.

<sup>94</sup> See e.g., OECD, ‘Competitive Neutrality: National Practices’ (OECD Publishing, 2012) <<http://www.oecd.org/daf/ca/50250966.pdf>> accessed 20 January 2016; OECD, *Financing State-Owned Enterprises: An Overview of National Practices* (OECD Publishing 2014).

<sup>95</sup> See e.g., OECD, ‘Levelling the International Playing Field Between Public and Private Business: What Have We Learnt So Far?’ (n 93); Przemyslaw Kowalski and others, ‘State-Owned Enterprises: Trade Effects and Policy Implications’ (2013) (n 77)147; Kowalski and Perepechay (n 37) 184; OECD, *State-Owned Enterprises as Global Competitors: A Challenge or An Opportunity?* (n 37).

agreements and bilateral investment agreements.<sup>96</sup> In 2016, the OECD assessed concerns and policy options for SOEs as global competitors from perspectives of international investment law, international trade law, competition law and corporate governance to maintain a level playing field and reconcile SOE public policy obligations.<sup>97</sup> It has argued that ‘governments should neither use SOEs to influence competition in international markets, nor unduly discriminate against foreign SOEs that trade and invest according to market principles’.<sup>98</sup>

In addition to the OECD, UNCTAD has also actively engaged in research on SOEs and competitive neutrality. For example, UNCTAD has explored the tendencies and relevant concerns of SOE investments in WIRs since 2009. In 2014, it focused on issues of competitive neutrality in a number of developing countries including China, India, Malaysia and Vietnam in comparison with existing CN policy in Australia.<sup>99</sup> This UNCTAD research has revealed that ‘most jurisdictions have considered the issue of competitive neutrality in developing their market, while the specific approach differs vastly’.<sup>100</sup> In particular, a chapter of the research has outlined SOE provisions in international agreements, showing that while a large number of agreements attempt to address the market behaviour of SOEs, international agreements have not evolved in many cases at the same rate as the characteristics and functions of SOE.<sup>101</sup>

While the two leading international organisations have provided some useful empirical evidence of SOEs and outline issues surrounding SOEs, only a small part of their research touches upon investment regulations for SOEs whilst the relevant analysis is neither comprehensive nor in-depth.

In the context of international investment law, SOEs have until recent years attracted little attention. Although I will elaborate and discuss these literatures in detail in

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<sup>96</sup> Kowalski and others, ‘State-Owned Enterprises: Trade Effects and Policy Implications’ (n 77) 37–42.

<sup>97</sup> OECD, *State-Owned Enterprises as Global Competitors: A Challenge or An Opportunity?* (n 37); Michael Gestrin and others, ‘Governments as Competitors in the Global Marketplace: Options for Ensuring a Level Playing Field’ (2016) <[www.e15initiative.org/](http://www.e15initiative.org/)> accessed 11 September 2017.

<sup>98</sup> Kowalski and Perepechay (n 37) 2; OECD, *State-Owned Enterprises as Global Competitors: A Challenge or An Opportunity?* (n 37) 157.

<sup>99</sup> UNCTAD, *Competitive Neutrality and Its Application in Selected Developing Countries* (n 64).

<sup>100</sup> *ibid.*

<sup>101</sup> Mott and Nawawi (n 64).

substantive chapters, it is necessary to address some important publications here. For instance, *Sovereign Investment: Concerns and Policy Reactions* in 2012 provided the first major holistic examination and interdisciplinary analysis of sovereign investments, including SWFs and SOEs.<sup>102</sup> A research handbook of SWFs published in 2015 investigated the juridical foundation of SWFs and investments, including national and international regulatory framework for SWFs and SWF investments protection.<sup>103</sup> In 2016, scholars from both China and the US together examined the domestic and global consequences of Chinese capitalism, focusing on the impact of Chinese SOEs on regulation and institutional policy from comparative perspective.<sup>104</sup> Also in 2016, the ICSID Review produced a special focus issue on SOEs which illustrated some important issues of SOE regulations in investment arbitration.<sup>105</sup>

Since 2010, a growing number of scholars has begun to discuss the legal issues surrounding SOE investments, such as the standing of SOEs in international investment treaties and arbitrations, treatment standards and national security concerns.<sup>106</sup> Some scholars also explored the regulatory framework for SOE investments from other perspectives. For example, Larry Becker addressed the regulation of SWFs and SOEs in times of crisis at both national and international

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<sup>102</sup> Sauvant, Sachs and Wouter P.F. Schmit Jongbloed (n 3).

<sup>103</sup> Fabio Bassan (ed), *Research Handbook on Sovereign Wealth Funds and International Investment Law* (EE Publishing 2015).

<sup>104</sup> Benjamin L Liebman and Curtis J Milhaupt (eds), *Regulating the Visible Hand?: The Institutional Implications of Chinese State Capitalism* (OUP 2015).

<sup>105</sup> Wang and Gallagher (n 3) 1-4.

<sup>106</sup> See, for example, Mark Feldman, 'The Standing of State-Owned Entities under Investment Treaties' in Karl P Sauvant (ed), *Yearbook on International Investment Law & Policy 2010–2011* (OUP 2012); Ji Li, 'State-Owned Enterprises in the Current Regime of Investor-State Arbitration' in Shaheza Lalani and Rodrigo Polanco Lazo (eds), *The Role of The State in Investor-State Arbitration* (BRILL 2015); Max Büge and others, 'State-Owned Enterprises in the Global Economy: Reason for Concern?' (*VOX CEPR's Policy Portal*, 2013) <<http://www.voxeu.org/article/state-owned-enterprises-global-economy-reason-concern>> accessed 11 September 2017; Paul Blyschak, 'State-Owned Enterprises and International Investment Treaties: When Are State-Owned Entities and Their Investment Protected?' (2011) 6 *Journal of International Law and International Relations* 1; Claudia Annacker, 'Protection and Admission of Sovereign Investment under Investment Treaties' (2011) 10 *Chinese Journal of International Law* 531; Walid B Hamida, 'Sovereign FDI and International Investment Agreements: Questions Relating to the Qualification of Sovereign Entities and the Admission of Their Investments under Investment Agreements' [2010] *The Law and Practice of International Courts and Tribunals* 17; Lauge N Skovgaard Poulsen, 'Investment Treaties and the Globalisation of State Capitalism: Opportunities and Constraints for Host States' in Roberto Echandi and Pierre Sauvé (eds), *Prospects in International Investment Law and Policy: World Trade Forum* (CUP 2013); Julien Chaisse and Dini Sejko, 'Investor-State Arbitration Distorted: When the Claimant Is a State' in Leïla Choukroune (ed), *Judging the State in International Trade and Investment Law: Sovereignty Modern, the Law and the Economics* (Springer 2016).

levels and discussed Chinese SOEs' investments as a case study.<sup>107</sup> Ming Du focused on the regulation of Chinese SOE in national foreign investment laws,<sup>108</sup> while Karl Sauvant explored the main issues relating to home country measures and their impacts on SOEs and the implications for competitive neutrality.<sup>109</sup> Sean Miner addressed the SOE rules in TPP,<sup>110</sup> while Ines Willemyns outlined the existing disciplines on SOEs in international economic law, arguing that it is necessary to provide a specific rules for SOEs,<sup>111</sup> etc. As stated, I will revisit their key arguments in subsequent main chapters.

It is worth stressing here that the growing body of literature on the role of SOEs in foreign investment is mostly quite recent, whereas the substantive issues reviewed in this thesis have been under discussion for much longer in international investment law.<sup>112</sup> Nonetheless, current research on the role of SOEs and the regulatory framework for SOEs from an investment perspective is still unclear and unsatisfactory. On the one hand, primary materials including international investment agreements, investment arbitral cases and domestic legislation on SOEs are limited, divergent and rapidly evolving. On the other hand, secondary materials on SOE investments and policy responses are still very incipient, fragmented and debatable. Consequently, there are some research gaps in interactions between SOEs and international investment law.

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<sup>107</sup> Backer (n 42).

<sup>108</sup> Ming Du, 'The Regulation of Chinese State-Owned Enterprises in National Foreign Investment Laws: A Comparative Analysis' (2016) 5 *Global Journal of Comparative Law* 118.

<sup>109</sup> Sauvant and others (n 68).

<sup>110</sup> Miner (n 81).

<sup>111</sup> Willemyns (n 81).

<sup>112</sup> For literatures on international investment law and arbitration, in general, see e.g., Rudolf Dlozer and Christoph Schreuer, *Principles of International Investment Law* (Second Edi, OUP 2012); Jeswald W Salacuse, *The Law of Investment Treaties* (Second Edi, OUP 2015); August Reinisch (ed), *Standards of Investment Protection* (OUP 2008); Marc Bungenberg and others (eds), *International Investment Law: A Handbook* (Hart Publishing 2015); Catharine Titi, *The Right to Regulate in International Investment Law* (Hart Publishing 2014); Peter Muchlinski, Federico Ortino and Christoph Schreuer (eds), *The Oxford Handbook of International Investment Law* (OUP 2008); Peter T Muchlinski, *Multinational Enterprises and The Law* (Second Edi, OUP 2007); Michael Waibel, *Sovereign Defaults before International Courts and Tribunals* (CUP 2011); Norah Gallagher and Wenhua Shan, *Chinese Investment Treaties: Policies and Practice* (OUP 2009); Chester Brown (ed), *Commentaries on Selected Model Investment Treaties* (OUP 2013).

However, regulating SOEs in the international arena is not an easy task. In fact, states have mixed views on SOE investments due to various political, economic and cultural considerations.<sup>113</sup> Moreover, the international investment law regime is presenting more complexities and problems where both developed and developing countries have been debating the reform of the IIA regime.<sup>114</sup> Furthermore, the globalisation of SOEs may intensify the current divergence and even politicise the reform of investment law regime.<sup>115</sup> Clearly, previous research is not enough.

It is important to clarify here that it is difficult to provide a thorough and convincing literature review on SOEs in international investment law. As will be shown in substantive chapters, the matter of SOEs is often dealt with through implication in primary materials, or materials are simply silent, leaving it open to interpretation and the pattern of implication, omission and silence is often replicated in literature scrutinising the primary materials. Hence, this section only attempts to provide a general picture of the current literature, and I will conduct a systematic review and analysis of both primary materials and secondary literature on SOEs and international investment law in substantive chapters.

## 1.5 This Thesis: Purposes, Methods, Structure and Main Findings

Against the above backdrop, this thesis attempts to provide a novel and systematic review and analysis of the existing international investment law regime governing SOE investments, with a view to strike a proper balance between protecting foreign

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<sup>113</sup> For example, while some countries have raised concerns over foreign SOEs, they are not willing to lose the important source of FDI by SOEs. Also, emerging economies with major interests of SOE investments are undoubtedly wishing to promote the protections of SOE investments at both national and international levels. By contrast, Western countries as hosts are attempting to strengthen regulations against foreign SOEs to minimise potential risks.

<sup>114</sup> The universe of investment treaties continues to grow and there are 3324 agreements in total; meanwhile, some governments have terminated their investment treaties and the megaregional agreements are increasingly difficult to negotiate and implement (for example, the TPP), UNCTAD, 'World Investment Report 2017- Investment and Digital Economy' (United Nations Publication 2017) 20-1 <[http://unctad.org/en/PublicationsLibrary/wir2017\\_en.pdf](http://unctad.org/en/PublicationsLibrary/wir2017_en.pdf)>. Moreover, the number of international investment arbitrations is growing and host states are facing more challenges and difficulties in regulating foreign investors and investments. See also UNCTAD, *WIR 2016* (n 3) 108.

<sup>115</sup> For example, the rise of sovereign investors has been assumed as a highly politicised and sensitive development in the international investment regime, Poulsen (n 106) 89.

SOE investment and addressing the host state's right to regulate SOEs in its national interests. The intention of this PhD thesis is to analyse to what extent international investment law protects SOEs as investors and to what extent these protections take into account the twin objectives of preserving host states' interests while facilitating investment promotion and liberalisation through international investment treaties. To this end, it will a) investigate whether and how current investment law regime addresses issues surrounding SOE investments; b) assess whether the evolution of the international investment law regime has provided adequate responses to the rise of SOEs; and c) how to improve the international investment law regime to achieve the proper balance between protecting foreign investment, regardless of whether it is publicly or privately owned, and protecting the host state's interests. This thesis, therefore, is not just about SOE investments. Rather, it aims to address evolving realities in today's world, including the rise of SOEs and state capitalism. It is further intended to analyse whether the international investment law regime as it is evolving and changing has adequately responded to these changes as well as being equipped with rules for good governance and sustainable development.

This thesis is primarily a doctrinal study by offering some historical (how the IIA regime and SOE rules have evolved) and normative analysis (whether the policy and legal responses are adequate and effective). It will explore the key provisions of international investment treaties, including definitions of investor and investment, foreign investment admission, substantive treatment standards and treaty exceptions, on the basis of a tremendous volume of international investment treaties and arbitral cases, to assess whether and how international investment law regulates SOE investments. Since the SOE as global investor is a relatively new issue in international investment law, with the relevant cases still being limited at the time the research was completed, this thesis will use hypotheses or analogies to analyse the regulatory responses and potential risks in relation to SOE investments. It will also adopt comparative studies to explore policy responses at both national and international levels, including domestic regulations on the admission of SOE investments and trends in investment treaty practice.

The thesis will progress as follows. As this chapter has briefly introduced the research background and explained the challenges posed by SOEs for the current investment

law regime, the following chapters will focus on the most important substantive issues surrounding SOEs in the context of international investment law. To be specific, Chapter 2 will focus on the qualification of SOEs for international investment protections, including whether SOEs are qualified ‘investors’, whether SOE investments are covered ‘investments’, and whether SOEs can initiate investor-state arbitrations. Chapter 3 will deal with the issue of admission of foreign SOEs, including domestic rules on the entry and establishment of foreign SOEs (especially FDI screenings) and investment treaty practice in relation to admission. Chapter 4 will explore whether and to what extent SOE investments can enjoy non-discriminatory treatment and FET under international investment agreements. Chapter 5 will move on to treaty exceptions to explore whether and to what extent host states’ restrictive measures against foreign SOEs can be justified under international investment law.

This thesis concludes in Chapter 6 that recent practice of the international investment law regime has generally achieved a balance of protections between foreign SOEs and host states, while further clarification of the key provisions would be very helpful in minimising potential risks. Furthermore, the international investment law regime for SOE investments should focus on the commercial capacity rather than the state ownership of the SOE investors, which implies that policymakers should act in the spirit of non-discrimination, liberalisation and balancing of interests.

This thesis will be useful for investment policy-making at both national and international levels, and contribute to ongoing debates on the reform of current investment law regime. The rapid growth of SOEs as a relatively new type of investors and the rise of ‘state capitalism’ indicate on the one hand that the landscape of international investments is changing. Meanwhile, the rising protectionism and safeguards in investment regime on the other hand need to be concerned with various national interest considerations and highly politically sensitive sovereign investments. All these changes raise the question of whether international investment law is catching up with these new realities and how the current international investment law regime accommodates changing circumstances. For instance, a real problem faced by policymakers is whether international investment law could minimise potential political risks posed by foreign SOEs or would politicise



investment disputes arising from SOE investments. This thesis reveals that some forms of regulation by host governments could potentially conflict with international obligations. Also, national restrictions on foreign SOEs in Western countries might discourage FDI by SOEs and generate a protectionist or political backlash against foreign investments from certain emerging economies. Hence, a further question may arise of whether the future international investment regime will enhance investment protection and liberalisation, or retreat from investment protection and even return to investment protectionism. In this context, it is hoped that this thesis can provide useful insights into changing realities of international investment law and make contributions to the work of enhancing governance and sustainability of the evolving international investment law regime.



## CHAPTER 2:

# ARE SOES QUALIFIED FOR INTERNATIONAL INVESTMENT PROTECTIONS

### 2.1 Introduction

Are state-owned enterprises (SOEs) qualified for international investment protections? This is a primary and fundamental problem in this thesis. Generally, only covered ‘investments’ made by qualified ‘investors’ are protected by the applicable investment treaty, including substantive protections such as non-discriminatory treatment and fair and equitable treatment, protection from expropriation without compensation; and procedural rights such as access to investor-state arbitration. Hence, it is of great importance to explore whether SOEs are qualified ‘investors’ and whether SOEs investments are covered ‘investments’ to ensure that SOEs could enjoy relevant international investment protections.

However, most investment treaties are silent on whether SOEs are qualified for investment protections.<sup>1</sup> As a result, arbitral tribunals will have considerable discretion to decide whether SOE investments are protected by the applicable international investment treaty. A more challenging question is whether an SOE can file a case against another state before an international tribunal? According to the ICSID Convention, only qualified ‘investment’ by a ‘national’ of contracting state falls within the jurisdiction of the ICSID.<sup>2</sup> The question then becomes whether SOE is a ‘national’ of the contracting state. Some argue that an SOE investing abroad may pursue non-commercial objectives, rather than commercial objectives, which either acts as a state organ or performs governmental functions.<sup>3</sup> In such a case, the SOE

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<sup>1</sup> An important reason for such a silence is because IIAs were not designed for protecting sovereign investments, see Ch1. Furthermore, as noted by Vandevelde, US BIT negotiators stipulated provisions for state enterprises in earlier BITs were to ensure that SOEs in the transitional economies were not used by host states to circumvent BIT obligations, rather than to protect US sovereign investments abroad, Vandevelde, *U.S. International Investment Agreements* 458.

<sup>2</sup> Article 25 (1) of the ICSID Convention.

<sup>3</sup> Although SOEs can act on the basis of commercial considerations, they may also pursue non-commercial priorities such as fulfil public service obligations. The boundary of commercial and non-commercial activities is

should be treated as a state, rather than a private investor, which is not eligible for the investor-state arbitration.<sup>4</sup> However, it is disputable whether an SOE investing abroad acts in governmental capacity rather than commercial capacity; hence, it is unclear whether an SOE can initiate an investor-state arbitration.

While a growing body of literature has explored the rise of SOEs and their standing in international arbitration,<sup>5</sup> the issue is far from being resolved. Moreover, although some SOEs have submitted claims to ICSID arbitration against host states, few arbitral tribunals have discussed whether the SOE was qualified as an ‘investor’ under the applicable treaty and met the criterion of ‘national’ of a contracting state under the ICSID Convention.<sup>6</sup> In addition, questions may arise of whether the SOE

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not always clear. In recent years, an increasing concern raises that a foreign government may be using SOEs as a vehicle for pursuing political or strategic objectives. See Przemyslaw Kowalski and others, ‘State-Owned Enterprises: Trade Effects and Policy Implications’ (2013) OECD Trade Policy Papers 147 <<http://dx.doi.org/10.1787/5k4869ckqk7l-en>> accessed 10 September 2017, 5; Paul Michael Blyschak, ‘State-Owned Enterprises in International Investment’ (2016) 31 ICSID Review 5, 5–6.

<sup>4</sup> As noted, in many countries, state enterprises still retain primacy in critical economic sectors and strategic industries. Foreign investors normally enter contracts with state enterprise to enter into these sectors. Many investment disputes arise in this scenario where SOEs breach the contract and foreign investors allege that the contractual breach of SOEs are attributable to states. In these cases, the tribunal assessed the circumstances under which acts of a SOE can be attributable to the state under both the ICSID Convention and ILC Articles on Responsibility of States for Internationally Wrongful Acts. See Muthucumaraswamy Sornarajah, *The International Law on Foreign Investment* (Third Edition, CUP 2010) 64–5. For more discussion see Michael Feit, ‘Responsibility of the State under International Law for the Breach of Contract Committed by a State-Owned Entity’ (2010) 28 Berkeley Journal of International Law 142–77..

<sup>5</sup> See, e.g., Paul Blyschak, ‘State-Owned Enterprises and International Investment Treaties: When Are State-Owned Entities and Their Investment Protected?’ (2011) 6 Journal of International Law and International Relations 1; Claudia Annacker, ‘Protection and Admission of Sovereign Investment under Investment Treaties’ (2011) 10 Chinese Journal of International Law 531; Mark Feldman, ‘The Standing of State-Owned Entities under Investment Treaties’ in Karl P Sauvant (ed), *Yearbook on International Investment Law & Policy 2010–2011* (Oxford University Press 2012) 615; Lu Wang, ‘State Controlled Entities as Qualified “Investors”: Implications for the Pacific Region Investment Treaty Making’ (2015) 12 Transnational Dispute Management <<https://www.transnational-dispute-management.com/article.asp?key=2188>> accessed 10 September 2017; Mark Feldman, ‘State-Owned Enterprises as Claimants in International Investment Arbitration’ (2016) 31 ICSID Review 24; Julien Chaisse and Dini Sejko, ‘Investor-State Arbitration Distorted: When the Claimant Is a State’ in Leila Choukroune (ed), *Judging the State in International Trade and Investment Law: Sovereignty Modern, the Law and the Economics* (Springer 2016) 77.

<sup>6</sup> The *CSOB* case was previously the most important exception where the tribunal had seriously discussed whether CSOB as a SOE could bring a claim under the ICSID Convention. Most recently, another ICSID tribunal, in the *BUCG v. Yemen* case, had discussed whether the Chinese SOE could bring a claim before the ICSID. See *Ceskoslovenska Obchodni Banka, A.S. v. The Slovak Republic*, ICSID Case No. ARB/97/4, Decision on Objections to Jurisdiction, 24 May 1999; *Beijing Urban Construction Group Co. Ltd v. Republic of Yemen*, ICSID Case No. ARB/14/30, Decision on Jurisdiction, 31 May 2017. Other cases brought by SOEs see e.g., *Hrvatska Elektroprivreda d.d. v. Republic of Slovenia*, ICSID Case No. ARB/05/24, Decision on the Treaty Interpretation Issue, 12 June 2009; *CDC Group plc v. Republic of Seychelles*, ICSID Case No. ARB/02/14,

investment is covered ‘investment’ given that the ICSID Convention does not define the term, and arbitral tribunals’ interpretations are divergent in practice. Thus, one may, for instance, argue that the ICSID tribunal has no jurisdiction for public investments or SOE conducts do not have the characteristics of investment.<sup>7</sup>

This chapter aims to investigate whether and to what extent SOEs are qualified for international investment protections by addressing three questions: first, whether SOEs are covered by the definition of ‘investors’ under IIAs; second, whether SOEs are entitled to initiate investor-state arbitrations under the ICSID Convention; third, whether SOE investments are covered by the definition of ‘investments’ under both investment treaties and the ICSID Convention. With the worldwide increasing sovereign investments and state protectionist measures against these investments, sovereign investors are likely to have recourse to treaty-based arbitration when running into disputes with host states.<sup>8</sup> In this sense, this chapter is of great importance for both SOE investors and host states to understand the standing of SOEs in investment treaties.

## 2.2 SOEs as Qualified ‘Investors’ under IIAs

### 2.2.1 SOEs under the Definition of ‘Investors’

The definition of investor provision plays a critical role in determining whether or not SOEs are qualified as investors under international investment treaties, including whether SOEs can enjoy substantive protections and whether SOEs have procedural rights in dispute resolution.<sup>9</sup> Investors normally refer to natural persons or juridical

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Annulment Decision, 29 June 2005; *Telenor Mobile Communications A.S. v. The Republic of Hungary*, ICSID Case No. ARB/04/15, Award, 13 September 2006.

<sup>7</sup> For example, some may argue that SOEs do not have high incentive as private companies for pursuing profits, so SOE activities lack the characteristics as ‘investments’. Or, they may argue that SOEs are supported by the government and lack accountability, thus SOE investment does not have risks.

<sup>8</sup> See Markus Burgstaller, ‘Sovereign Wealth Funds and International Investment Law’ in Chester Brown and Kate Miles (eds), *Evolution in Investment Treaty Law and Arbitration* (CUP 2011) 177; Lauge N Skovgaard Poulsen, ‘States as Foreign Investors: Diplomatic Disputes and Legal Fictions’ (2016) 31 ICSID Review 12, 16.

<sup>9</sup> Yuri Shima, ‘The Policy Landscape for International Investment by Government-Controlled Investors: A Fact Finding Survey’ (2015) OECD Working Papers on International Investment 2015/01  
<<http://dx.doi.org/10.1787/5js7svp0jkns-en>> accessed 10 September 2017, 10.

persons.<sup>10</sup> Although most IIAs define the term ‘investor’, the wording varies significantly among treaties. For instance, some treaties do not have a definition of ‘investor’, but provide the equivalent definition of ‘nationals’.<sup>11</sup> Furthermore, some treaties use the term ‘companies’,<sup>12</sup> ‘enterprises’,<sup>13</sup> ‘corporations’,<sup>14</sup> ‘legal entities’,<sup>15</sup> or ‘economic entities’<sup>16</sup> instead of the juridical or legal persons. As a result, the scope of ‘investor’ under a specific investment treaty might have a slight difference based on the term adopted.

Investors can be defined to exclude or include different types of entities according to certain characteristics, such as the legal personality, profit or non-profit status and the state ownership.<sup>17</sup> The main difference of SOE investors from private investors is, obviously, the state ownership. According to the OECD survey, however, most IIAs do not distinguish between investors on the basis of ownership.<sup>18</sup> For the purpose of my research, IIAs are divided into three types in respect of provisions of investor definition, namely, treaties not explicitly covering SOEs, treaties explicitly covering SOEs, and treaties explicitly covering both SOEs and the state.

#### *A. Treaties not explicitly covering SOEs*

The OECD survey demonstrates that the majority of IIAs define investors without an express reference to state entities and companies.<sup>19</sup> For example, the ‘investor’ under

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<sup>10</sup> For example, Article 1 (3) of the Finland-Kuwait BIT. See Rudolf Dlozer and Christoph Schreuer, *Principles of International Investment Law* (Second Edi, OUP 2012) 44; UNCTAD, ‘Scope and Definition: UNCTAD Series on Issues in International Investment Agreements II’ (UN Publication 2011) 72.

<sup>11</sup> See e.g., Cambodia-Viet Nam BIT (2001), Article 1(2); Algeria-Indonesia BIT (2000), Article 1(2); Indonesia-Sudan BIT (1998), Article I (2); Chile-Netherlands BIT (1998), Article I (b); Cambodia-Philippines BIT (2000), Article 1 (2); etc.

<sup>12</sup> See e.g., Peru-Singapore BIT; China-Brunei Darussalam BIT; etc.

<sup>13</sup> See e.g., Canada-El Salvador BIT; Canada-South Africa BIT; etc.

<sup>14</sup> See e.g., Kazakhstan-Malaysia BIT.

<sup>15</sup> See e.g., China-Uganda BIT.

<sup>16</sup> Many Chinese BITs use the term ‘economic entities’ for ‘investors’, see e.g., China-Djibouti BIT; China-Jordan BIT; etc.

<sup>17</sup> UNCTAD (n 10) 80–1.

<sup>18</sup> Of the 1813 agreements surveyed by the OECD, 1524 (80%) agreements are silent on whether SOEs are qualified as ‘investors’ under the definition clause, Shima (n 9) 11.

<sup>19</sup> *ibid.* See also Jo En Low, ‘State-Controlled Entities as “Investors” under International Investment Agreements’ [2012] 80 Columbia FDI Perspectives <[http://ccsi.columbia.edu/files/2014/01/FDI\\_80.pdf](http://ccsi.columbia.edu/files/2014/01/FDI_80.pdf)> accessed 10 September 2017.

the Morocco-Viet Nam BIT means, ‘any legal person having its head office in the territory of the Kingdom of Morocco or the Socialist Republic of Viet Nam and constituted under Moroccan or Vietnamese law respectively and making an investment in the territory of the other Contracting Party’.<sup>20</sup>

A definition not expressly covering SOEs can be found in the first BIT concluded between Germany and Pakistan in 1959, where the definition from the beginning was not restricted to any particular legal form.<sup>21</sup> Furthermore, the first BIT concluded by most states did not refer to the ownership or SOE under the definition of ‘company’.<sup>22</sup> There might be various reasons contributing to such a broad definition of investor. IIAs are primarily to promote and protect foreign investments, so a broad definition of investor could guarantee a wide range of protections for various kinds of investors and investments. Moreover, the existence of SOEs as active global investors has been a phenomenon since the twentieth century.<sup>23</sup> Thus, the earlier treaty drafters might have never thought that the absence of an explicit inclusion of SOEs in the definition of investor could someday be a problem.<sup>24</sup>

### *B. Treaties explicitly covering SOEs*

States that actively pursue investment activities - either directly or through government-owned entities - may wish to ensure that relevant entities, including SOEs and other sovereign investors, are protected by IIAs.<sup>25</sup> According to the OECD survey, many investment treaties expressly include SOEs in the definition of investor, and the frequency of treaties that explicitly include SOEs as protected investors are clearly rising.<sup>26</sup> In these treaties, SOEs are typically defined as either

<sup>20</sup> Morocco-Viet Nam BIT (2012), Article 1 (2) (b). Similar provisions see e.g., Greece -Viet Nam BIT (2008), Article 1(3); Malaysia-Slovakia BIT (2007), Article 1(b); Congo-Korea BIT (2005), Article 1(c); China-Uganda BIT (2004), Article 1(2); etc.

<sup>21</sup> See e.g., Germany-Pakistan BIT, Article 8 (4). Kenneth J Vandevelde, *Bilateral Investment Treaties: History, Policy, and Interpretation* (OUP 2010) 164.

<sup>22</sup> *ibid* 164–8. The exceptions include Austrian and US practices.

<sup>23</sup> Sornarajah (n 4) 63.

<sup>24</sup> As the OECD survey shows, most of the existing treaties were drafted before sovereign investors became prominent in the global market. In this context, the relative infrequency of explicit reference to SOEs may reflect the fact that not much attention would have been paid to them as investors at the time of drafting. Shima (n 9) 11.

<sup>25</sup> UNCTAD (n 10) 81.

<sup>26</sup> According to the OECD survey, 287 (16%) IIAs specify that SOEs are covered; furthermore, until the early

‘governmentally owned’ or ‘governmentally owned or controlled’.<sup>27</sup> For example, the Mexico-India BIT defines that ‘investor’ includes ‘enterprise of a Contracting Party’ which refers to ‘any entity... whether privately or governmentally owned...’<sup>28</sup> Concepts such as ‘public institutions’<sup>29</sup> and ‘governmental institutions’<sup>30</sup> are also used.<sup>31</sup> Although the specific language differs in investor definition clauses, these treaties expressly include that SOEs are qualified ‘investors’ for protection under the treaty.

Nevertheless, treaty practice in respect of investor definitions varies significantly across countries. The US, Australia, Canada, Japan and the UAE are the countries which most often include SOEs explicitly in the definition of investor (Figure 2.1).<sup>32</sup> By contrast, most European countries do not mention sovereign investors in their treaties at all.<sup>33</sup> Interestingly, China as a main source of sovereign investments seldom includes any explicit references to sovereign investors in their IIAs,<sup>34</sup> even though this situation has changed in some recent Chinese treaties.<sup>35</sup>

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1980s very few treaties mentioned SOEs in the investor definition, while in the past few years IIAs have come to address SOEs regularly, Shima (n 9) 11–2.

<sup>27</sup> *ibid* 12.

<sup>28</sup> India-Mexico BIT (2007), Article 1(3) & (8).

<sup>29</sup> Some treaties involving Italy contain the word ‘public institution’ (*istituti pubblici*). A public institution in Italy is a juridical person established according to public law through which the public administration exercises its functions in the general interest, Federico Ortino, ‘Italy’ in Chester Brown (ed), *Commentaries on Selected Model Investment Treaties* (OUP 2013) 330. See also, e.g., Article 1 (2) & (4) of the Egypt-Indonesia BIT, which provide that ‘judicial person’ covered in ‘investor’ shall mean ‘any entity established in accordance with, and recognized as a juridical person by the law of the State, such as public institutions, corporations, foundations, private companies, firms, establishments and organizations’.

<sup>30</sup> See e.g., Article 1 (3) of the Malaysia-Saudi Arabia BIT (2000), which provides that investor includes ‘the Government of the Kingdom of Saudi Arabia and its financial institutions and authorities such as the Saudi Arabian Monetary Agency, public funds and other similar governmental institutions existing in Saudi Arabia’.

<sup>31</sup> Shima (n 9) 12.

<sup>32</sup> *ibid* 13; Annacker (n 5) 537–9; Wang (n 5) 13..

<sup>33</sup> Poulsen, ‘States as Foreign Investors: Diplomatic Disputes and Legal Fictions’ (n 8) 15.

<sup>34</sup> *ibid*.

<sup>35</sup> Most of the recent concluded Chinese treaties explicitly include SOEs as protected investors, see e.g., China-Canada BIT (2013), Article 1 (1) & (10); Australia-China FTA (2015), Article 9.1; China-Republic of Korea FTA (2015), Article 12.1; China-Japan-Korea trilateral investment agreement (2012), Article 1 (4); etc.



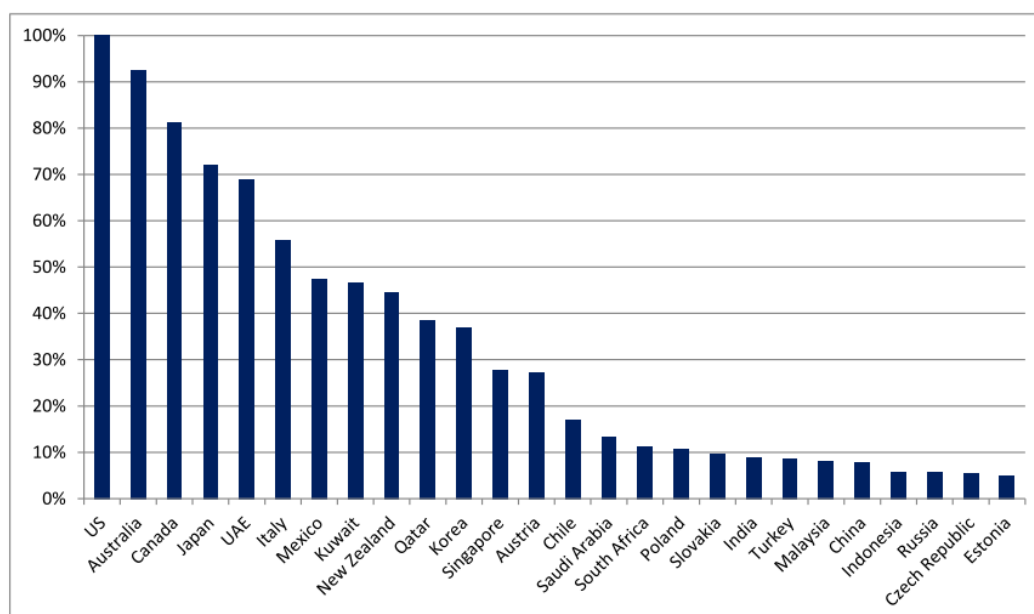


Figure 2.1 Share of IIAs that explicitly cover SOEs under the definition of ‘investor’, by country

Source: Shima, ‘The Policy Landscape for International Investment by Government-Controlled Investors: A Fact Finding Survey’ (OECD 2015)

The motives for including SOEs vary among countries. For some countries like the Arab countries, such express inclusion is to rule out any doubt that their sovereign investments are protected by the relevant BITs signed.<sup>36</sup> In contrast, for other countries like the US, such inclusion is to ensure that state enterprises were not used to circumvent BIT obligations.<sup>37</sup> Accordingly, the express inclusion of SOEs in the investor definition clause might serve two goals: one is to clarify the scope of treaty coverage, and the other is to clarify the content of treaty coverage. The former means that foreign state or public investors should be protected alongside foreign private investors. The latter would also be reflected in the standards of treatment. For example, if SOEs are covered as protected ‘company’, then SOEs in host states would be potential comparators for purposes of establishing the national treatment standard.<sup>38</sup> Foreign investors should, therefore, be accorded treatment equal not only to domestic private investors, but also to domestic state or public investors.

It is notable that there are three BITs with Panama that explicitly exclude SOEs in

<sup>36</sup> Hamida 21.

<sup>37</sup> Vandevelde, *U.S. International Investment Agreements* (n 1) 193.

<sup>38</sup> Vandevelde, *Bilateral Investment Treaties: History, Policy, and Interpretation* (n 21) 159.

the definition of investor.<sup>39</sup> The reason for such exclusion is not clear, and the exclusion does not apply to SOEs of the treaty partners, i.e., the UK, Germany and Switzerland.<sup>40</sup>

### *C. Treaties expressly covering states*

Among the treaties which expressly include SOEs, some treaties go further to cover states as investors explicitly (Figure 2.2).<sup>41</sup> The Arab states, especially Kuwait, Qatar, UAE and Saudi Arabia, typically include their governments in the definition of investors in treaties that they concluded.<sup>42</sup> For example, the Kuwait-South Africa BIT provides that ‘the Contracting Party itself’ and ‘any State entity’ are protected investors, and the latter is defined as ‘a department of government, corporation, institution or undertaking wholly or partially owned or controlled by the government and engaged in activities of a commercial nature’.<sup>43</sup> Similarly, the 2012 US Model BIT provides that ‘investor of a Party’ means ‘a Party or state enterprise thereof, or a national or an enterprise of a Party’.<sup>44</sup>

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<sup>39</sup> Panama-Germany BIT (1983), Panama-Switzerland BIT (1983) and Panama-UK BIT (1983).

<sup>40</sup> For example, Article 1(d) of the Panama-United Kingdom BIT (1983) provides that, ‘companies’ means ‘all those juridical persons constituted in accordance with legislation in force in Panama... which have their domicile in the territory of the Republic of Panama, excluding State-owned enterprises’, but no such exclusion for companies in respect of the UK.

<sup>41</sup> Shima (n 9) 13.

<sup>42</sup> Annacker (n 5) 531–2..

<sup>43</sup> Article 1 (2) of the Kuwait-South Africa BIT (2005). Likewise, Article 1 (2) (b) of the China-UAE BIT (1993) provides that ‘investor’ in respect of the United Arab Emirates includes (1) the Federal Government of the UAE; (2) the Local Governments and their local and financial institutions; (3) the natural and legal person who have the nationality of the UAE; (4) companies incorporated in the UAE; but the investor in respect of China does not include the Chinese governments.

<sup>44</sup> 2012 US Model BIT, Article 1. See also e.g., US-Rwanda BIT, Article 1; 2004 Canada Model BIT, Article 1; Canada-Peru BIT, Article 1; Colombia- Japan BIT (2011), Article 1(b); etc.

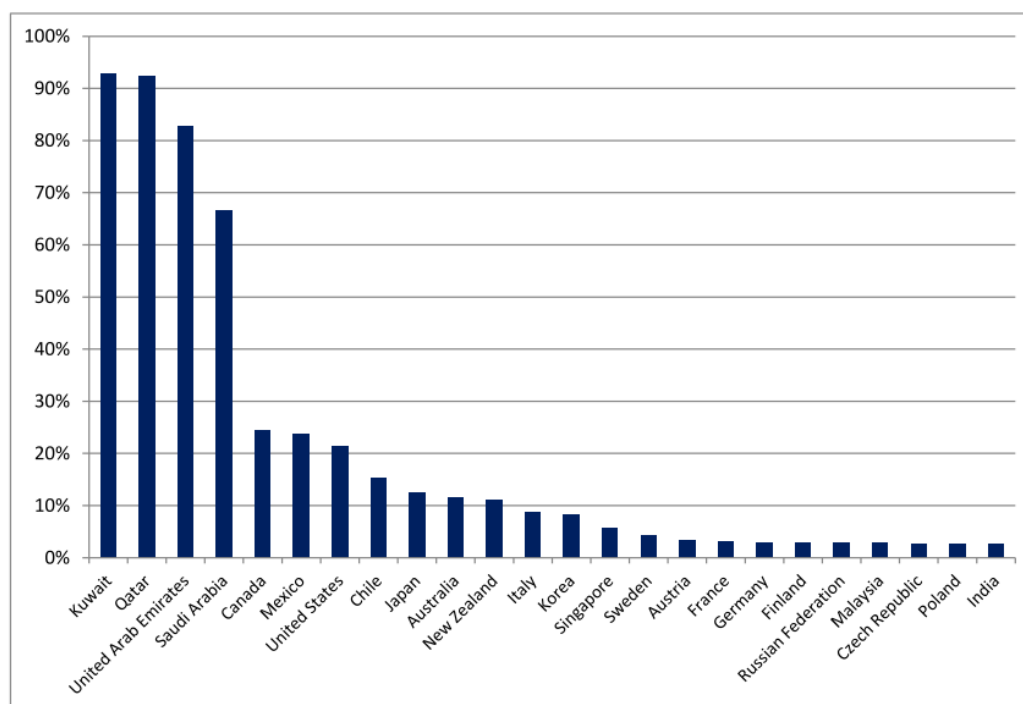


Figure 2.2 Share of IIAs that explicitly cover states under the investor definition, by country

Source: Shima, 'The Policy Landscape for International Investment by Government-Controlled Investors: A Fact Finding Survey' (OECD 2015)

It is also notable that a few treaties explicitly refer to specific governmental authorities or institutions as protected investors.<sup>45</sup> For example, the Kuwait-Germany BIT provides that 'investor' in respect of Kuwait includes 'the government of the State of Kuwait acting either directly or indirectly through the Kuwait Investment Authority or its offices abroad as well as development funds, agencies or other similar government institutions having their seats in Kuwait'.<sup>46</sup> The Kuwait-Canada BIT specifies that, 'the Kuwait Fund for Arab Economic Development and the Kuwait Investment Authority are investors of Kuwait'.<sup>47</sup> Likewise, the Saudi Arabia-India BIT provides that investor in respect of Saudi Arabia includes 'the Government of the Kingdom of Saudi Arabia and its financial institutions and authorities such as the Saudi Arabian Monetary Agency, public funds and other similar governmental

<sup>45</sup> Shima (n 9) 14.

<sup>46</sup> Article 1 (3) of the Germany-Kuwait BIT (1994); 'Investor' in respect of Germany does not include neither the government nor any governmental institutions. Similar provisions see also, e.g., Article 1 (2) of the Germany-United Arab Emirates BIT (1997).

<sup>47</sup> Article 1 of the Canada-Kuwait BIT (2011). The express 'for greater certainty' used in the definition clause of investor aims to further clarify the status of Kuwait Fund for Arab Economic Development (KFAE) and the Kuwait Investment Authority (KIA) as investors.

institutions existing in Saudi Arabia'.<sup>48</sup> Undoubtedly, the above treaties that expressly include contracting states and specific governmental institutions as qualified investors indicate that the contracting states wish to extend investment protections to states and certain governmental institutions.

Such an explicit inclusion may have two implications. First, it helps to promote public investment. This is typical in Arab states, especially considering the fact that some Arab countries carry on investment activities either directly or through public structures.<sup>49</sup> Second, it could guarantee that SOEs and state entities be protected as investors, regardless of whether such state entities will be interpreted as states. According to the ILC's Articles on State Responsibility, conduct of state entities might be attributable to the state in certain circumstances.<sup>50</sup> If the treaty expressly includes state itself as qualified investors, SOEs or state entities would indisputably fall within the scope of qualified investors and thus be covered by the applicable treaty protection.

However, it is noteworthy that the explicit inclusion of the state in the definition of investor does not serve only one end, i.e., extending the treaty protection to public investments including the state itself and state enterprises; it may also effectively impose obligations on the SOE as if it were a state, especially when the two terms appear in the same clause of investor definition simultaneously. For example, the US 2012 BIT defines the 'investor of a Party' as 'a Party or state enterprise thereof, or a national or an enterprise of a Party'.<sup>51</sup> Such wording seems to suggest that the state

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<sup>48</sup> Article 1 (3) (b) (III) of the India-Saudi Arabia BIT (2006).

<sup>49</sup> Hamida (n 36) 21.

<sup>50</sup> Article 4 (Conduct of organs of a State) provides: 1) The conduct of any State organ shall be considered an act of the State under international law, whether the organ exercises legislative, executive, judicial or any other functions, whatever position it holds in the organization of the State, and whatever its character as an organ of the central government or of a territorial unit of the State. 2) An organ includes any person or entity which has that status in accordance with the internal law of the State. Article 5 (Conduct of persons or entities exercising elements of governmental authority) provides: The conduct of a person or entity which is not an organ of the State under Article 4 but which is empowered by the law of that State to exercise elements of the governmental authority shall be considered an act of the State under international law, provided the person or entity is acting in that capacity in the particular instance. Article 8 (Conduct directed or controlled by a State) provides: The conduct of a person or group of persons shall be considered an act of a State under international law if the person or group of persons is in fact acting on the instructions of, or under the direction and control of, that State in carrying out the conduct.

<sup>51</sup> Article 1 of the 2012 US Model BIT.

enterprise equates to the state, rather than a national or an enterprise, which may in turn make it possible to extend the treaty obligations of states to state enterprise.

On the whole, a review of existing investment treaties illustrates that in almost all cases, SOEs are not explicitly excluded from the investor definition,<sup>52</sup> regardless of whether expressly covering states and state enterprises or not. Although treaty practices on the definition of investor are disordered and unsystematic (even in the same state) and the specific language varies in IIAs, many newly concluded agreements tend to expressly include state enterprises and even states as qualified investors.<sup>53</sup> For example, the TPP defines that ‘investor’ means ‘a Party, or a national or an enterprise of a Party’, and the ‘enterprise’ means ‘any entity... whether privately or governmentally owned or controlled’.<sup>54</sup> Also, the Argentina-Qatar BIT defines that the term ‘investor’ includes ‘juridical person, whether privately or governmentally owned or controlled’, and ‘juridical persons’ include ‘official agencies, sovereign funds, trusts, and organisations established or organised in accordance with the respective state legislation of the Contracting Parties’.<sup>55</sup> Although the express inclusion of SOEs and states in recent treaties do not mean a significant evolution of the definition of investor, it at least demonstrates a trend that SOEs investing abroad is attracting more attention and likely to be discussed more frequently in the future.

### 2.2.2 SOEs Considered as ‘Investors’ When the Treaty is Silent

SOEs or state entities are qualified investors without any doubt if they are expressly included in the definition of investor. The problem is, however, when the treaty is

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<sup>52</sup> As mentioned earlier, there are only three exceptions in BITs with Panama and the exclusion of state enterprises only applies to investors of Panama.

<sup>53</sup> For instance, the Chile-Hong Kong, China SAR BIT (2016), Nigeria-Singapore BIT (2016), Canada-EU CETA(2016), Canada-Mongolia BIT (2016), Canada-Hong Kong, China SAR BIT (2016), Mexico-UAE BIT (2016), Nigeria-UAE BIT (2016), Kuwait-Kyrgyzstan BIT (2015), Australia-China FTA (2015), Canada-Korea FTA (2014), Australia-Korea FTA (2014), Canada-Honduras FTA (2013) expressly provide that ‘investor of the Party’ includes ‘the Party’ and ‘state enterprises’. Meanwhile, some BITs, e.g., Japan-Kenya BIT (2016), Iran, Islamic Republic of - Japan BIT (2016), Iran, Islamic Republic of - Slovakia BIT (2016), Japan-Oman BIT (2015), Japan-Myanmar BIT (2013), Japan-Mozambique BIT (2013), Benin- Canada BIT (2013), China-Japan-Korea trilateral investment agreement (2012) expressly include state enterprises as qualified investors.

<sup>54</sup> Article 9.1 & Article 1.3 of the TPP.

<sup>55</sup> Article 1 (1) of the Argentina-Qatar BIT (2016).

silent, will an SOE or state entity still be considered as a protected investor under the applicable treaty?

Scholars normally maintain that SOEs and state entities are covered as investors if not explicitly excluded.<sup>56</sup> Annacker considers that relying on the ordinary meaning, entities or companies that are owned or controlled by the state or one of its subdivisions are generally covered by the terms ‘legal persons’ or ‘juridical entities’, regardless of their form, functions and purpose.<sup>57</sup> Moreover, the object and purpose of investment treaties are to protect and promote investments, which do not draw any distinction between investments made by public investors and that of private investors.<sup>58</sup> Vandeveldel also believes that when the language does not expressly state whether the investor definition includes those governmentally-owned entities and privately-owned entities, the definition clause may be phrased in terms broad enough to include both governmental and private entities implicitly.<sup>59</sup> Nevertheless, one may challenge these arguments because the treaty language of investor definition is unclear and ambiguous. Hence, there exists uncertainty as to whether sovereign investors are qualified investors if the investment treaty does not expressly include them in the investor definition.

In practice, arbitrators would have to decide whether the investment treaty regime covers SOEs when an express inclusion is absent. Until now, there have been some claims filed by sovereign investors for investment arbitrations,<sup>60</sup> but few tribunals have addressed the issue of whether sovereign investors qualified as investors under the applicable treaty.<sup>61</sup> Meanwhile, respondent states were often surprisingly quiet on

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<sup>56</sup> Hamida (n 36) 21.

<sup>57</sup> Annacker (n 5) 539.

<sup>58</sup> *ibid.*

<sup>59</sup> Vandeveldel, *Bilateral Investment Treaties: History, Policy, and Interpretation* (n 21) 159.

<sup>60</sup> For example, *BUGC* (n 6); *HEP* (n 6); *Telenor* (n 6); *CSOB* (n 6); *Abengoa, S.A. y COFIDES, S.A. v. United Mexican States*, ICSID Case No. ARB(AF)/09/2, Award, 18 April 2013; *Hanocal Holding B.V. and IPIC International B.V. v. Republic of Korea*, ICSID Case No. ARB/15/17, 2015, discontinued; *State General Reserve Fund of the Sultanate of Oman v. Republic of Bulgaria*, ICSID Case No. ARB/15/43, 2015, pending; *OAO Tatneft v. Ukraine*, UNCITRAL, Award on the Merits, 29 July 2014; *Generation Ukraine, Inc. v. Ukraine*, ICSID Case No. ARB/00/9, Award, 16 September 2003; *Oschadbank v. Russian Federation*, UNCITRAL, 2016, pending; etc. For more discussion about the cases, see Feldman, ‘The Standing of State-Owned Entities under Investment Treaties’ (n 5) 624–30; Chaisse and Dini (n 5) 94–7.

<sup>61</sup> For example, in the *HEP* and *Telenor* cases, tribunals just confirmed that investment protections apply to state

the issue, and the claims proceeded as if sovereign investors were naturally covered by investment treaties.<sup>62</sup> For example, when the Swedish SOE, Vattenfall, filed two investment claims against Germany under the ECT, which followed the vast majority of IIAs by not explicitly covering sovereign investors but not excluding them either,<sup>63</sup> no party had publicly questioned the qualification of Vattenfall as an investor for investment protections.<sup>64</sup>

The situation, however, may change according to the recent arbitral practice. In the *Tatneft v. Ukraine* case,<sup>65</sup> for example, the respondent state alleged that Tatneft was a governmental entity, and the Ukraine-Russia BIT only protected private investors.<sup>66</sup> In particular, Ukraine relied on the ILC's Articles on State Responsibility to argue that Tatneft met the structural and functional tests for attribution of its conduct to Russia. The Paris Court, however, rejected this argument, noting that firstly, the BIT's text did not require investors to be private entities; and secondly, the attribution test under the ILC Articles for determining state responsibility was in an 'entirely different' context from determining whether a BIT claimant can be

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entities without detailed analysis; in the famous *CSOB* case, the tribunal discussed whether CSOB falls within the personal jurisdiction under the ICSID Convention, rather than whether CSOB was a qualified investor under the BIT. Feldman, 'The Standing of State-Owned Entities under Investment Treaties' 624–30 (n 5); Annacker (n 5) 542.

<sup>62</sup> Poulsen, 'States as Foreign Investors: Diplomatic Disputes and Legal Fictions' (n 8) 16.

<sup>63</sup> Article 1 (7) of the ECT defines 'investor' with respect to a Contracting Party as natural person, and company or other organization organized in accordance with the law applicable in that Contracting Party.

<sup>64</sup> *ibid.* For more discussion on *Vattenfall* case, see Luke Eric Peterson, 'German media reveal details of Vattenfall claim v. Germany; NGOs raise enviro fears as two arbitrators named' *IARReporter* (27 July 2009) <<http://tinyurl.com/pjszjb9>> accessed 2 May 2017; Nathalie Bernasconi, 'Background Paper on Vattenfall v. Germany Arbitration' (IISD July 2009) <[https://www.iisd.org/pdf/2009/background\\_vattenfall\\_vs\\_germany.pdf](https://www.iisd.org/pdf/2009/background_vattenfall_vs_germany.pdf)> accessed 12 September 2017.

<sup>65</sup> Notably, the awards (on jurisdiction and on merits) remain unpublished to date, but on 29 November 2016, the Paris Court of Appeal released a decision on judicial review. For the original French version see <<https://www.italaw.com/sites/default/files/case-documents/italaw7882.pdf>> accessed 12 September 2017. For more discussion see the Editorial, 'UPDATED: Paris Court of Appeal weighs in on Russia-Ukraine BIT awards' *IARReporter* (30 November 2016) <<http://tinyurl.com/zy17tde>> accessed 8 May 2017; Damien Charlotin, 'Previously-unseen jurisdictional award waves away objections to Russian-owned investment claim' *IARReporter* (19 April 2017) <<http://tinyurl.com/n44q4oq>> accessed 8 May 2017. For the factual background, see Damien Charlotin, 'In long-confidential Russia-Ukraine BIT award, tribunal reviews evidence of alleged "black raid" by oligarch, facilitated by Ukraine's courts and Prosecutor' *IARReporter* (7 April 2017) <<http://tinyurl.com/lmrjv9>> accessed 8 May 2017.

<sup>66</sup> Article 1 (2) of the Ukraine-Russia BIT defines investor as: 'b) any legal entity, set up or instituted in conformity with the legislation prevailing on the territory of the given Contracting Party, under the condition that the said legal entity is legally capable, under the legislation of its respective Contracting Party, to carry out investments on the territory of the other Contracting Party'.

assimilated to a state.<sup>67</sup> Interestingly, although the Paris Court did recognise Tatneft's connections to the Russian government, it held that did not deprive Tatneft of 'structural, organic and decisional autonomy' and was insufficient to assimilate Tatneft to the state itself.<sup>68</sup> In the tribunal's view, Tatneft's connection with the government was perhaps 'inevitable' in the context of the former Soviet Republics' conversion to market economies, and that did not mean that the company lost its essential commercial aims.<sup>69</sup> The current arbitral practice, nonetheless, is still very limited, and it is impossible to predict whether or not future tribunals would come to the same conclusion.

Meanwhile, arbitral tribunals are not unanimous on the question of an SOE's status as an investor. In *Abengoa S.A. y Cofides S.A. v. Mexico*,<sup>70</sup> for instance, Mexico alleged that the Spanish state's fund (FIEX), not COFIDES (the second claimant), was the true investor; and the BIT did not define 'investors' to include relevant contracting states.<sup>71</sup> The majority held that, firstly, under the Mexican law, COFIDES, not the Spanish government, was the owner of the investment; any delegation of the FIEX did not affect its ownership or 'control' of the shares in SDS.<sup>72</sup> Secondly, the majority found that COFIDES did not act as an 'agent' of the state. Thus there was no need to analyse whether or not a state is a protected investor under the BIT.<sup>73</sup> The majority held that 'being state-owned did not alter the commercial nature of COFIDES' activities and the private nature of the relevant investment', and the BIT

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<sup>67</sup> Editorial, 'UPDATED: Paris Court of Appeal weighs in on Russia-Ukraine BIT awards' (n 65).

<sup>68</sup> The Court noted that: (1) 36% of Tatneft's shares were held by the semi-autonomous Russian republic of Tatarstan; (2) Tatarstan might hold a 'golden share' to veto over certain Tatneft decisions; and (3) Tatarstan's president sat as the chairman of Tatneft's board. Furthermore, the Court observed that Tatneft made a statement in 2006 that the Tatarstan government exercised a 'significant influence' on the company. *ibid.*

<sup>69</sup> *ibid.*

<sup>70</sup> Filip Balcerzak and Luke Eric Peterson, 'Newly Obtained Mexico BIT Award Reveals that Arbitrators Disagreed on Jurisdiction over State-Owned Claimant; Details Emerge of Final Settlement Sum' *IARReporter* (21 May 2014) <<http://tinyurl.com/pmzcmge>> accessed 8 May 2017. For more see *Abengoa* (n 60).

<sup>71</sup> According to Article 1 (5) of the Mexico-Spain BIT, 'investor' means 'companies, defined as, legal entities, including companies, associations, companies, corporations, branches and other organizations that are constituted or, in any case, duly organized under the law of a Contracting Party and have their seat in the territory of that Party Contracting'.

<sup>72</sup> The majority held that even if the ownership was not established, COFIDES controlled the shares for purposes of Mexican law; and a same conclusion would be held according to Spanish law, see Balcerzak and Peterson (n 70).

<sup>73</sup> *ibid.* The majority noted that COFIDES is not 'integrated within the general administration of the state and does not exercise any prerogative of a public authority'.



did not exclude SOEs from its scope.<sup>74</sup> However, one arbitrator held that the claim fell outside the scope of the tribunal's jurisdiction because COFIDES was actually a 'vehicle' of the investment - the 'depository' or 'custodial' agent for the FIEX.<sup>75</sup> Furthermore, the dissenter noted that COFIDES was merely a 'manager' under the instructions of the Fund, and the potential loss or damage was borne by FIEX.<sup>76</sup> Although this tribunal did not further discuss whether states were protected investors under the BIT, the arbitrators, obviously, had no consensus in determining the 'investors' when an SOE is involved.

It is notable that disputes involving SOEs often raise the question of whether the SOE acts in its own commercial capacity or should be viewed as a state, i.e., as an entity that acts in governmental capacity. In practice, tribunals have discussed whether host states were responsible for the conduct of state-owned entities, relying on ILC Articles on State Responsibility. A typical case is *Maffezini v. Spain* where the tribunal had to answer whether the Spanish SOE, SODIGA, was a state entity or characterised as a private commercial corporation for jurisdiction. Following the 'structural' and 'functional' tests for attribution set out in ILC Articles on State Responsibility, the tribunal concluded that SODIGA was an entity of the Spanish state, because it was created by a state decree, was majority-owned by the government (structural test), and carried out governmental functions for promoting regional development (functional test).<sup>77</sup> While most of the cases were concerned with the attribution, not the status of the SOE investing abroad when the treaty is silent, arbitral decisions have at least implied that it is possible for tribunals to turn to the attribution tests, i.e., the structural and functional tests, in determining the status of the SOE investing abroad, i.e., whether the SOE acts as a state or a company.

However, the issue of attribution itself is problematic and disputable. For example,

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<sup>74</sup> *ibid.*

<sup>75</sup> *ibid.*

<sup>76</sup> *ibid.*

<sup>77</sup> *Emilio Agustín Maffezini v. The Kingdom of Spain*, ICSID Case No. ARB/97/7, Decision of the Tribunal on Objections to Jurisdiction, 25 January 2000, paras 74-5, 89. Likewise, in a newly released ICSID decision, the tribunal adopted the same test and concluded that acts of two Egyptian SOEs were attributed to Egypt, see *Ampal-American and others v. Egypt*, ICSID Case No. ARB/12/11, Decision on Liability and Heads of Loss, 21 February 2017, paras 71, 138-9, 145-6.

the Paris Court in reviewing the *Tatneft* case mentioned that the tests for the attribution of conduct for determining state responsibility under the ILC Articles was developed in the ‘entirely different’ context of determining whether a BIT claimant can be assimilated to a state.<sup>78</sup> Furthermore, arbitral practice is not consistent in attributing conduct of the state-owned entity to the state. For example, in *Ampal-American and others v. Egypt*, the dispute arose out of alleged breaches of a long-term contract of natural gas supply between the claimants and two Egyptian SOEs, EGPC and EGAS.<sup>79</sup> The tribunal held that actions of SOEs were attributable to Egypt, because SOEs’ funds came directly from the state while their profits went to the state, and SOEs’ board members were recommended by the state. Also, EGPC and EGAS had always acted under the direction of Egypt (satisfying ILC Article 8) and that Egypt had anyway acknowledged all SOEs’ conducts as its own (satisfying ILC Article 11).<sup>80</sup> Likewise, in *Flemingo Duty Free v. Poland*, the tribunal held that the Polish state-owned airport operations company, PPL, was a *de facto* state organ whose action could be attributed to the state.<sup>81</sup> In particular, although the tribunal acknowledged that PPL was an independent SOE, it also noted that: (1) PPL was owned by the Polish State Treasury and was required to obtain state approval for various transactions; (2) PPL’s mission was not typically a private business function and Poland had said that PPL was performing a strategic function for the state; and (3) PPL was clearly controlled by the Ministry of Transport.<sup>82</sup>

Notably, the *Almås v. Poland* tribunal came to an opposing conclusion, i.e., none of the impugned conduct of the Polish land agency, ANR, in relating to a long-standing farming venture could be attributed to the Polish state.<sup>83</sup> The tribunal firstly held that ANR could not be considered as a state organ *de jure* because it had independent

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<sup>78</sup> Editorial, ‘UPDATED: Paris Court of Appeal weighs in on Russia-Ukraine BIT awards’ (n 65).

<sup>79</sup> *Ampal-American and others* (n 77).

<sup>80</sup> *ibid.* Jarrod Hepburn, ‘In new Egypt ruling, disproportionate contract termination and failure to prevent pipeline attacks underpin Fortier-chaired tribunal’s findings of BIT breach’ *IAReporter* (28 February 2017) <<http://tinyurl.com/hrqtylu>> accessed 9 May 2017.

<sup>81</sup> *Flemingo Duty Free Shop Private Limited v. Republic of Poland*, UNCITRAL, Award, 12 August 2016, paras 418-48.

<sup>82</sup> Luke Eric Peterson, ‘n new BIT award, arbitrators deem state-owned company to be a state organ, and see FET and expropriation violations due to contract termination’ *IAReporter* (1 November 2016) <<http://tinyurl.com/j4dpca8>> accessed 9 May 2017.

<sup>83</sup> *Kristian Almås and Geir Almås v. The Republic of Poland*, PCA Case No. 2015-13, Award, 27 June 2016, paras 207-72.

legal personality under local law;<sup>84</sup> nor was the ANR viewed as a state organ *de facto* because it engaged in commercial transactions on its own account - even though these were important to the national economy and the ANR was supervised by the Ministry of Agriculture.<sup>85</sup> Secondly, the tribunal held that the termination of the lease by the ANR was not performed in the exercise of governmental authority - unsatisfying ILC Article 5 - nor on the instructions of the Polish government - unsatisfying ILC Article 8.<sup>86</sup> Similarly, in *Tenaris and Talta v. Venezuela*,<sup>87</sup> the tribunal held that CVG FMO was not a 'state organ' because its acts were purely commercial and had no bearing on the legislative, executive, judicial or other function of the Venezuelan state - even though it was clearly a state-owned entity; also, CVG FMO was not empowered to exercise governmental authority, but operated in a more modest and commercial manner.<sup>88</sup> Whether a state-owned entity acts as a state - either as a state organ or empowered to exercise governmental function - is a very complex issue, where the tribunal might come to distinct conclusions under the customary international law as codified in the ILC Articles on State Responsibility.

Most importantly, while SOEs may exercise dual functions in its national economy, it is disputable whether and to what extent an SOE investing abroad could behave in its governmental capacity and thus be regarded as a state. A 2011 report from the International Energy Agency, for example, stated that Chinese state-owned oil companies are driven by commercial interests, rather than acting as puppets of the government.<sup>89</sup> In fact, no sufficient evidence has shown that an SOE investing

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<sup>84</sup> Similar conclusions see also *Gustav F W Hamster GmbH & Co KG v. Republic of Ghana*, ICSID Case No. ARB/07/24, Award, 18 June 2010, paras 199-201; *EDF (Services) Ltd v. Romania*, ICSID Case no ARB/05/13, Award, 8 December 2009, para 190; *Bayindir Insaat Turizm Ticaret ve Sanayi A.S. v. Islamic Republic of Pakistan*, ICSID ARB/03/29, Award, 27 August 2009, para 119.

<sup>85</sup> Luke Eric Peterson, 'Poland prevails in face of claim under Norway investment treaty; Crawford-chaired tribunal analyzes attribution issues' *IARReporter* (23 August 2016) <<http://tinyurl.com/hm2pdee>> accessed 9 May 2017.

<sup>86</sup> *ibid.* *Almås* (n 83), paras 214-72.

<sup>87</sup> *Tenaris S.A. and Talta - Trading e Marketing Sociedade Unipessoal Lda. v. Bolivarian Republic of Venezuela*, ICSID Case No. ARB/11/26, Award, 29 January 2016.

<sup>88</sup> The tribunal also noted that it had not seen any persuasive evidence that the CVG FMO acted as a puppeteer of the Venezuelan state that sought to manipulate Matesi's access to raw materials. Luke Eric Peterson, 'In Tenaris award, a purchasing contract is not deemed part of protected investment; arbitrators see discrimination, but can't see attribution' *IARReporter* (15 February 2016) <<http://tinyurl.com/jcp4e92>> accessed 9 May 2017.

<sup>89</sup> Julie Jiang, 'IEA: China's oil companies aren't puppets' *UPI* (Paris, 18 February 2011)

abroad aims to pursue political priorities. Furthermore, it is not uncommon for a state to engage in commercial activities and there exist ‘grey zones’ between commercial and non-commercial capacities. As a result, when the investment treaty is silent, tribunals may turn to customary international law, i.e., the attribution test in ILC Articles on State Responsibility, to decide the status of an SOE investing abroad. Although the decision should be made on a case-by-case basis, there exist risks for SOEs investing abroad to be characterised as a state rather than a corporate entity, and thus be excluded from the scope of investment treaties. As a result, it is very important for those states that wish to protect SOEs investing abroad to explicitly include SOEs as ‘investors’ in the investment treaty.

### 2.2.3 States Considered as ‘Investors’ When the Treaty is Silent

A more controversial and challenging issue is whether a state qualifies as an ‘investor’ if not expressly covered in the applicable treaty. Some scholars consider that:

The question whether State-owned or controlled enterprises are covered by an investment agreement has to be treated differently from the question whether States parties to the agreement themselves can act as investors. Usually, State enterprises are covered even if not explicitly stated while States themselves tend not to be unless this is expressly provided for.<sup>90</sup>

However, treaty negotiators or arbitrators may have a different view. According to Article 31(1) the Vienna Convention on the Law of Treaties (VCLT), a treaty shall be interpreted in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in light of its object and purpose. This rule must be followed by tribunals when dealing with investment disputes. The ‘investor’ definition includes ‘legal persons’ or ‘juridical entities’ constituted under the laws of a contracting party, and the ordinary meaning of the term ‘legal person’ or ‘juridical

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<<http://www.upi.com/Energy-News/2011/02/18/IEA-Chinas-oil-companies-arent-puppets/42251298034373/>> accessed 9 May 2017.

<sup>90</sup> UNCTAD, *International Investment Agreements: Key Issues (Volume I)* (UN Publication 2004) 142. See also Hamida (n 36) 21.

entities' does not countenance an exclusion of state investor.<sup>91</sup> This assumption was considered in the negotiation of the Multilateral Agreement on Investment (MAI), where most delegations thought that the concept of a legal person or the definition of SOE would cover the situation where a state was an economic actor, and considered that the State as such would otherwise be protected by diplomatic processes under international law.<sup>92</sup>

The Swiss Federal Department of Foreign Affairs (FDFA) considers that there is no reason why a state may not qualify as an investor.<sup>93</sup> In terms of the divergence between public and private entities, the opinion from the FDFA held that, with the exception of a limited number of cases in which the state has immunity (acts *jure imperii*), there are no legal grounds, under public international law and national case-law, to treat public and private investments differently.<sup>94</sup> In other words, sovereign investors should not be differentiated from private investors unless in the case of state immunity.

The issue of whether or not a state can be considered as a qualified 'investor' has important implications for SOEs as it can further guarantee the qualification of SOEs as investors: since the SOE is sometimes suspected to be the agent of the state, if the state is a qualified investor, the SOE is undoubtedly qualified as an investor. Indeed, it is not uncommon for a state to conduct commercial activities and such public investments should not be prohibited or treated differently. In such a case, the capacity of a state is similar to that of a private investor which therefore should qualify for investment protections. This interpretation may help to distinguish state activities from state enterprise activities. In other words, the state is different from state enterprises in principle, and the only exception is when the state conducts commercial activities. However, without expressly covering states in the investor

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<sup>91</sup> Annacker (n 5) 533.

<sup>92</sup> Drafting Group No.3 on Definition, Treatment and Protection of Investors and Investments, 'Report to the Negotiating Group' (OECD 1996) 6 <<http://www1.oecd.org/daf/mai/pdf/dg3/dg3963e.pdf>> accessed 12 September 2017; Negotiating Group on the MAI, 'The Multilateral Agreement on Investment: Commentary to the Consolidated Text' (OECD 1998) 5 <<http://www1.oecd.org/daf/mai/pdf/ng/ng988r1e.pdf>> accessed 12 September 2017.

<sup>93</sup> Hamida (n 36) 22.

<sup>94</sup> Annacker (n 5) 535.

definition, the host state might challenge the status of the state investing abroad as a qualified investor. Nevertheless, when a state invest abroad, i.e., acts primarily as an ‘investor’ in another country, it is more likely to be acting on a commercial rather than political basis. As such it should enjoy the same protection afforded other ‘investors’. However, the further question is that in case a state does not enjoy immunity and is qualified as an investor under the treaty, should the state resort to investor-state or state-state mechanisms to resolve investment disputes?

At the time of writing, investment claims brought by states are very rare, so it is unclear and unpredictable whether or not tribunals would consider that a state is a qualified investor for investment protection if the treaty is silent. In *Kaliningrad Region v. Lithuania*, the tribunal had to determine whether a Russian regional government, Kaliningrad, was a qualified ‘investor’ under the Russia-Lithuania BIT.<sup>95</sup> While Lithuania questioned that Kaliningrad should resort the state-to-state mechanism, the tribunal considered that BIT referred to Russian law for guidance as to which persons and entities could be considered ‘investors’; hence, the Kaliningrad regional government qualified as an investor under the investor definition.<sup>96</sup> However, the persuasiveness of this interpretive approach may be disputable in other further investment arbitration cases because of the special investor definition under the Russia-Lithuania BIT.<sup>97</sup>

Nonetheless, whether or not a state can be considered as a qualified investor under the investment treaty is likely to be more important and frequently scrutinised, particularly given the large volumes of foreign investments made by states or state-controlled entities. Recently, the Republic of Tatarstan filed a claim under the

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<sup>95</sup> See Editorial, ‘Lithuania prevails in investor-state BIT claim over enforcement of ICC award in case brought by Russian regional Gov’t’ *IAReporter* (17 March 2009) <<http://tinyurl.com/pquy5fr>> accessed 9 May 2017. Notably, the final award of the case has not been published, but the Paris Court of Appeal in 2010 released a judgement on application to set aside the award, *Kaliningrad Region v. Lithuania*, ICC, Judgment of the Paris Court of Appeal on application to set aside award (French), 18 November 2010.

<sup>96</sup> Article 1 (1) (b) of the Russia-Lithuania BIT defines ‘investor’ in respect of Russia Federation as ‘any legal person, constituted or established according to the legislation in force in the territory of the Russian Federation provided this legal person is authorised according to the legislation of the Russian Federation to invest in the territory of the Republic of Lithuania’. *ibid.*

<sup>97</sup> *ibid.*

UNCITRAL rules against Ukraine pursuant to the Russia-Ukraine BIT.<sup>98</sup> While the tribunal has not made any decision, it is reported that Ukraine views the case should resort to a state-to-state mechanism while an investor-state tribunal would lack jurisdiction.<sup>99</sup> If so, the tribunal is likely to determine whether or not the Ministry of Land and Property Relations of the Republic of Tatarstan is qualified as an investor to bring a case, since the BIT does not expressly define the contracting state or the state entity as an ‘investor’.<sup>100</sup> It is interesting to note that one arbitrator in this tribunal has chaired the Lithuania case,<sup>101</sup> but whether this tribunal would adopt the same approach is still unknown.

In short, there is limited discussion of whether SOEs and states fall into the category of qualified investors under applicable treaties in arbitral practice. Clearly, a clear and refined definition of investors which expressly includes SOEs and states would diminish the potential for conflicting interpretations. Besides, as arbitral practices have shown, national legislation may play a significant role in clarifying the status of corporations or entities as qualified investors, considering most BITs requiring incorporation or establishing as a legal entity according to domestic law. However, given the lack of conformity between treaty practice and national practice, and the growth of public investment in global markets, the issue of whether or not state enterprises and states are protected by the same international legal regime that protects private foreign investors is likely to be discussed more frequently.

### 2.3 Can SOEs Initiate Investor-State Arbitration under Article 25 of ICSID Convention

In order to guarantee the effectiveness of treaty protection, most investment treaties

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<sup>98</sup> Luke Eric Peterson and Zoe Williams, ‘Tribunals finalized in two Russian-related investment treaty arbitrations (ICSID and UNCITRAL), with Boeckstiegel once again in a familiar role’ *IARReporter* (16 March 2017) <<http://tinyurl.com/jdc4ly9>> accessed 9 May 2017.

<sup>99</sup> *ibid.*

<sup>100</sup> Article 1 (2) of the Russian Federation-Ukraine BIT (1998) provides that:

Investor of a Contracting Party shall imply (a) any natural person...; (b) any legal entity, set up or instituted in conformity with the legislation prevailing on the territory of the given Contracting Party, under the condition that the said legal entity is legally capable, under the legislation of its respective Contracting Party, to carry out investments on the territory of the other Contracting Party.

<sup>101</sup> Peterson and Williams (n 98).

have provided dispute resolution mechanisms, including investor-state arbitration and state-state arbitration.<sup>102</sup> The question of whether SOEs are qualified investors is linked to but different from the question of whether they have standing before an investor-state arbitration. They are linked together because the treaty provisions in respect of investor-state arbitration often refer to the investor definition in order to define the scope of the investors eligible to bring a case against the host state. Thus, only when SOEs are qualified as covered investors, can the treaty protection then be applicable to them. As a result, where SOEs and states are expressly covered in the investor definition clause, they would have the standing to enforce the treaty rights through an investor-state arbitration. On the contrary, if the treaty is silent, SOEs and even states might still have standing if the tribunal determines that the investor definition includes state-owned entities and contracting parties.<sup>103</sup> However, it should be noted that a qualified ‘investor’ under the BIT is not necessarily guaranteed access to international investment arbitration, as it also has to meet the requirements imposed by the rules of arbitration to which the BIT refers. As most investment arbitrations are conducted under the ICSID Convention, it is, therefore, important to take a close look at the ICSID Convention and relevant practice to gain further insights into the issue.

Article 25 (1) of the ICSID Convention provides that the Centre’s jurisdiction extends to ‘any legal dispute arising directly out of an investment, between a Contracting State... and a national of another Contracting State, which the parties to the dispute consent in writing to submit to the Centre’.<sup>104</sup> This article sets out core requirements of the ICSID jurisdiction, including the subject matter of the dispute (jurisdiction *ratione materiae*) and the parties to the dispute (jurisdiction *ratione personae*). Furthermore, to establish the jurisdiction, both parties must have expressed their consent to arbitration.<sup>105</sup> In this context, in order to gain access to

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<sup>102</sup> See, e.g., Canada-Egypt BIT, Article 13&15; Canada-Philippines BIT, Article 13 & 15; Egypt-Italy BIT, Article 9 & 10; Kuwait-Belgium-Luxembourg BIT, Article 9 & 10; Qatar-Switzerland BIT, Article 8 & 9; Qatar-Germany BIT, Article 11 & 10; UAE-United Kingdom BIT, Article 8 & 9; US-Argentina BIT, Article 7 & 8; US-Bulgaria BIT, Article 6 & 7; etc.

<sup>103</sup> Annacker (n 5) 550–1.

<sup>104</sup> Article 25 (1) of the ICSID Convention.

<sup>105</sup> Dlozer and Schreuer (n 10). The investor’s ‘consent’ to arbitration is often found in the investor’s Request for Arbitration, while the host state’s ‘consent’ to the ICSID arbitration is often expressed in the investment treaty,



dispute settlement under the ICSID Convention, an SOE is required to be ‘a national of another Contracting State’.

It is, however, not clear whether SOEs or public investors are entitled to initiate a claim before the ICSID.<sup>106</sup> As stipulated in Article 25 (2) (b), ‘national of another Contracting State’ means ‘any natural person’ and ‘any juridical person’, without a distinction between private and public investors.<sup>107</sup> As a result, it is arguable that an SOE or a state entity is considered as a ‘national’ of the contracting party and thus enjoys access to the ICSID arbitration.

Pursuant to its Preamble, the ICSID was established for the promotion of private international investment.<sup>108</sup> Some scholars accordingly maintain that the language of the Preamble ‘would indicate that the investor must be a private individual or corporation’ and thus ‘States acting as investors have no access to the Centre in that capacity’.<sup>109</sup> Moreover, the Report of the Executive Directors has mentioned ‘private international capital’ and ‘private international investment’ in many places.<sup>110</sup>

The above interpretations, however, are not convincing. According to Article 31 of the VCLT, the treaty shall be firstly interpreted in accordance with the ordinary meaning, and the purpose and object shall be considered as a supplementary approach. In fact, the Preamble of the ICSID Convention has never expressly excluded public investors and their investments from the protection, although it was

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see Feldman, ‘The Standing of State-Owned Entities under Investment Treaties’ (n 5) 616–7.

<sup>106</sup> For more discussion see *generally*, Christoph H Schreuer, *The ICSID Convention: A Commentary* (Second Edi, CUP 2009).

<sup>107</sup> Article 25 (2) of the ICSID Convention provides:

National of another Contracting State’ means: (a) any natural person...; and (b) any juridical person which had the nationality of a Contracting State other than the State party to the dispute on the date on which the parties consented to submit such dispute to conciliation or arbitration and any juridical person which had the nationality of the Contracting State party to the dispute on that date and which, because of foreign control, the parties have agreed should be treated as a national of another Contracting State for the purposes of this Convention.

<sup>108</sup> The Preamble speaks specially that, ‘[c]onsidering the need for international cooperation for economic development, and the role of *private* international investment therein’. Dolzer and Schreuer (n 10) 250.

<sup>109</sup> Schreuer (n 106) 161.

<sup>110</sup> International Bank for Reconstruction and Development, ‘Report of the Executive Directors on the Convention on the Settlement of Investment Disputes between States and Nationals of Other States’ (1965) <<http://icsidfiles.worldbank.org/icsid/ICSID/StaticFiles/basicdoc/partB-section03.htm>> accessed 12 September 2017, Section III.

considering ‘the need for international cooperation for economic development, and the role of private international investment therein’.<sup>111</sup> Moreover, the jurisdiction of the ICSID provided in Article 25 is not restricted to private investments and private investors.

Some scholars consider that claims brought by SOEs or state entities under BITs should be settled through other procedures such as the state-state arbitration - the basic idea of the ICSID Convention is to fill a particular procedural gap by providing for dispute settlement between foreign investors and host states.<sup>112</sup> While ICSID tribunals do not have jurisdiction over disputes between two contracting states,<sup>113</sup> the ICSID Convention has never excluded public investors from its jurisdiction, as long as the public investor has been considered as ‘a national of the Contracting State’. Moreover, the state-state dispute settlement in most investment treaties is provided for certain claims, including diplomatic protection, interpretation or declaratory relief.<sup>114</sup> Accordingly, even if an SOE or state entity is characterised as a state, its claim may fall outside the scope of the state-state dispute settlement. Therefore, it is not reasonable to preclude public investors from the ICSID jurisdiction merely in light of the state ownership of the claimant of the investment dispute.

It is notable that during the preparation of the ICSID Convention, drafters were disposed to accept state entities and contracting states as eligible ‘nationals’ to bring a claim against host states. The comment to the Preliminary Draft of the Convention by the Executive Directors of the International Bank for Reconstruction and Development (IBRD) stated that:

[T]he definitions have been broadly drawn. ‘Nationals’ include both natural

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<sup>111</sup> The Preamble of the ICSID Convention.

<sup>112</sup> Schreuer (n 106) 160; Feldman, ‘The Standing of State-Owned Entities under Investment Treaties’ (n 5) 636..

<sup>113</sup> For example, the *Maffezini* tribunal held that the center ‘has no jurisdiction to arbitrate disputes between two States... it also lacks jurisdiction to arbitrate disputes between two private entities’, see *Maffezini* (n 77), para 74.

<sup>114</sup> Anthea Roberts, ‘State-to-State Investment Treaty Arbitration: A Hybrid Theory of Interdependent Rights and Shared Interpretive Authority’ (2014) 51 *Harvard International Law Journal* 1, 69–70; Nathalie Bernasconi-Osterwalder, ‘State–State Dispute Settlement in Investment Treaties’ (IISD 2014) 7–16

<<https://www.iisd.org/sites/default/files/publications/best-practices-state-state-dispute-settlement-investment-treaties.pdf>> accessed 12 September 2017; Vandevelde, *Bilateral Investment Treaties: History, Policy, and Interpretation* (n 21) 499–50.

and juridical persons as well as associations of such persons. It will be noted that the term ‘national’ is not restricted to private-owned companies, thus permitting a wholly or partially government-owned company to be a party to proceedings brought by or against a foreign State.<sup>115</sup>

However, neither the ICSID Convention nor the associated report by the Executive Directors of IBRD has mentioned SOEs or public investors; instead, they repeatedly speak of private foreign investments.<sup>116</sup> Hirsch argues that ICSID tribunals should ‘adopt a narrow interpretation, rejecting the participation of bodies that cooperate with states’.<sup>117</sup> Such a narrow interpretation is justified by virtue of the aim of the drafters of the Convention, who rejected attempts to involve any additional state (apart from the host state) in arbitration proceedings, ‘even where those states played an important role in the investment transaction’.<sup>118</sup> Accordingly, ICSID arbitration may not be available to states themselves and their subdivisions even if they are protected investors for purposes of an applicable investment treaty that provides for ICSID arbitration.<sup>119</sup>

In the author’s view, however, the interpretation of excluding state enterprises and states from jurisdiction *ratione personae* of the ICSID is not convincing. On the one hand, state enterprises are clearly different from states, although the conduct of SOEs or state entities may be attributable somehow to the states. Scholars who have argued that the ICSID framework excludes SOEs or state entities are in fact assuming that public investors are states *per se*, and exclude them from the ICSID jurisdiction accordingly. In *Tulip v. Turkey*, for example, the tribunal held that:

[T]here is no basis under international law to conclude that ownership of a corporate entity by the State triggers the presumption of statehood...whilst state ownership may, in certain circumstances, be a factor relevant to the question of attribution, it does not convert a separate corporate entity into an

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<sup>115</sup> ICSID, *History of the ICSID Convention: Volume II-1* (ICSID Publishing 2009) 230.

<sup>116</sup> Hamida (n 36) 24–5.

<sup>117</sup> Moshe Hirsh, *The Arbitration Mechanism of the International Centre for the Settlement of Investment Disputes* (Martinus Nijhoff 1993) 55–6; Hamida (n 36) 26.

<sup>118</sup> *ibid* 26.

<sup>119</sup> Piero Bernardini, ‘Nationality Requirements under BITs and Related Case Law’ in Federico Ortino and others (eds), *Investment Treaty Law: Current Issues II* (BIICL 2007) 17–24.

‘organ’ of the State.<sup>120</sup>

Also, the *Electrabel v. Hungary* tribunal stated that:

...[T]he fact that a State acts through a State-owned or State-controlled company over which it exercises some influence is by itself insufficient for the acts of such entities to be attributed to the State. This has been expressed in the clearest possible terms in the ILC Commentary under Article 8.<sup>121</sup>

On the other hand, scholars have confused the dual role of states in international investments, namely, states as regulators (in governmental capacity) and states as investors (in commercial capacity). As mentioned earlier, it is not uncommon that a state acts through a state enterprise or in its own name to engage in international investments. While scholars consider that SOEs investing abroad in a governmental capacity cannot submit a claim against states under the ICSID Convention,<sup>122</sup> the evidence is not enough to suggest that a state enterprise or even a state investing abroad exercises its governmental capacity, rather than commercial capacity.<sup>123</sup> In such a case, the state or state enterprise, in fact, acts as a foreign investor, rather than a regulator of inward investments.

The Chinese State Administration of Foreign Exchange (SAFE), for example, is a government organ of China acting as the regulator of foreign exchange in principle, but it also has the commercial capacity to engage in international financial

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<sup>120</sup> *Tulip Real Estate and Development Netherlands B.V. v. Republic of Turkey*, ICSID Case No. ARB/11/28, Award, 10 March 2014, para 289. In addition, the tribunal agreed with the *EDF* tribunal that, ‘state-owned corporations possessing legal personality under [municipal] law separate and distinct from that of the State, may [not] be considered as a State organ’, *EDF* (n 84), para 190.

<sup>121</sup> *Electrabel S.A. v. Republic of Hungary*, Decision on Jurisdiction, 30 November 2012 (ICSID Case No. ARB/07/19), para 7.95. The ILC Commentary stated that:

The fact that the State initially establishes a corporate entity, whether by a special law or otherwise, is not a sufficient basis for the attribution to the State of the subsequent conduct of that entity. Since corporate entities, although owned by and in that sense subject to the control of the State, are considered to be separate, prima facie their conduct in carrying out their activities is not attributable to the State unless they are exercising elements of governmental authority within the meaning of article 5.

See James Crawford, *The International Law Commissions Articles on State Responsibility: Introduction, Text and Commentaries* (CUP 2002).

<sup>122</sup> Feldman, ‘State-Owned Enterprises as Claimants in International Investment Arbitration’ (n 5) 24.

<sup>123</sup> See also Section 2.2.3.

activities.<sup>124</sup> If the SAFE purchased US Treasury bills and then had a dispute relating to this, can the SAFE bring a case against the US Government under the ICSID? Obviously, in this hypothetical case, the SAFE acts as an investor in a commercial capacity rather than as a regulator in a governmental capacity. The question whether the conduct of a state organ can be attributable to the state is normally discussed under state responsibility in international law. But here we are discussing whether the SAFE shall be excluded from the ICSID arbitration because of its public body status even if it acts as an investor. According to Article 25 of the ICSID Convention, the question becomes whether or not the state is a ‘national’ of the state, namely, whether the Chinese SAFE is ‘a national of China’ under the ICSID Convention?

According to Article 25 (2) (b) of the ICSID Convention, ‘a national of another Contracting State’ includes ‘juridical person’ that has the ‘nationality’ of that state.<sup>125</sup> However, these terms are defined broadly under the ICSID Convention, which does not specify any particular test to determine the nationality of a ‘juridical person’.<sup>126</sup> As a result, whether there is a ‘juridical person’ that has the ‘nationality’ of a contracting state in dispute is determined by that state in light of its domestic legislation.<sup>127</sup> Hence, the question in the above example becomes whether or not the SAFE is a juridical person under Chinese law. According to the *General Principles of the Civil Law of China*, an independently funded state organ shall have legal personality from the date of its establishment.<sup>128</sup> Apparently, the SAFE is a qualified

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<sup>124</sup> For major functions of the SAFE see <<http://www.safe.gov.cn/wps/portal/english/AboutSAFE/Major>> accessed 18 May 2017.

<sup>125</sup> Article 25 (2) (b) of the ICSID Convention provides:

[A]ny juridical person which had the nationality of a Contracting State other than the State party to the dispute on the date on which the parties consented to submit such dispute to conciliation or arbitration and any juridical person which had the nationality of the Contracting State party to the dispute on that date and which, because of foreign control, the parties have agreed should be treated as a national of another Contracting State for the purposes of this Convention.

<sup>126</sup> Anthony C Sinclair, ‘ICSID’s Nationality Requirements’ (2008) 23 ICSID Review 57, 88.

<sup>127</sup> As noted, ICSID tribunals have drawn from the fact that, ‘the Convention does not define corporate nationality that the drafters’ intention was to leave in the hands of each state the power to determine whether a company does or does not have its nationality, within broad limits imposed by international law’, *ibid* 87–8.

<sup>128</sup> See Article 50 of the General Principles of the Civil Law of China. Similarly, on 15 March 2017, the General Rules of the Civil Law of the People’s Republic of China has been adopted at the Fifth Session of the 12<sup>th</sup> National People’s Congress of the PRC, and will be effective from 1 October 2017. Article 97 of the Rules provides that ‘[t]he governmental bodies with independent funds and the statutory bodies that bear administrative functions shall have the legal personality of governmental bodies from the date of their establishment, and may engage in the civil activities required for the performance of their functions’.

legal person under the Chinese law, so it should have the standing under the ICSID Convention. Although it is hard to say, *prima facie*, a ‘state’ is ‘a national of the state’, the government or governmental organ could qualify as a ‘national’ of the state logically and legally. The situation is clearer when it comes to state entities as long as they are qualified legal persons under domestic legislation and have the nationality of the contracting state in dispute. However, given that national legislation varies in respect of juridical persons, a risk exists that a state entity might not be considered as a juridical person under the domestic law. In such a case, the state entity might be denied access to ICSID arbitration on the ground that it was not qualified as ‘a national of the contracting state’ under the ICSID jurisdiction.

Some ICSID tribunals have acknowledged that SOEs are qualified as the ‘national of another Contracting State’ under the ICSID Convention,<sup>129</sup> but neither the respondent state nor the tribunal has seriously addressed the issue of jurisdiction *ratione personae* becoming involved with SOEs.<sup>130</sup> One exception is the *Rumeli v. Kazakhstan* case, where the respondent state challenged the jurisdiction of the ICSID tribunal, arguing that the claimants (Rumeli and Telsim) were just empty shells for the ICSID arbitration, while the Turkish state was the true party.<sup>131</sup> The tribunal held that claimants had the standing to bring the arbitration under Article 25 of the ICSID Convention<sup>132</sup> In particular, the tribunal pointed out that Article 25 (2) (b) ‘was inserted to broaden the scope of ICSID jurisdiction and not to limit it’.<sup>133</sup>

In *CSOB v. Slovak*, the tribunal for the first time discussed whether an SOE qualified as a national of another contracting state to bring a claim before the ICSID.<sup>134</sup> In the tribunal’s view, the language of Article 25 (1) ‘makes clear that the Centre does not have jurisdiction over disputes between two or more Contracting States’. But, the history of the ICSID Convention indicated that the concept of ‘juridical persons’ was

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<sup>129</sup> Schreuer (n 106) 162.

<sup>130</sup> See e.g., *HEP* (n 6); *CDC* (n 6); *Telenor* (n 6); etc. See also Poulsen, ‘Investment Treaties and the Globalisation of State Capitalism: Opportunities and Constraints for Host States’ 78.

<sup>131</sup> *Rumeli Telekom A.S. and Telsim Mobil Telekomunikasyon Hizmetleri A.S. v. Republic of Kazakhstan*, Award, 29 July 2008 (ICSID Case No. ARB/05/16), para 324.

<sup>132</sup> *ibid.*, para 331.

<sup>133</sup> *ibid.*, para 329.

<sup>134</sup> *CSOB* (n 6).

‘not intended to be limited to private-owned companies, but to embrace also wholly or partially government-owned companies’.<sup>135</sup> More importantly, the tribunal adopted Mr Broches’ formulation as an ‘accepted test’ to examine whether an SOE qualified as ‘a national of another Contracting State’ under Article 25 (1), namely:

...[F]or purposes of the Convention a mixed economy company or government-owned corporation should not be disqualified as ‘a national of another Contracting State’ unless it is acting as an agent for the government or is discharging an essentially governmental function.<sup>136</sup>

Relying on the test, the tribunal eventually concluded that CSOB qualified as a ‘national’ under the ICSID Convention.<sup>137</sup> As the tribunal noted:

It cannot be denied that for much of its existence, [CSOB served as agent or representative of the state] ... *But in determining whether CSOB, in discharging these functions, exercised governmental functions, the focus must be on the nature of these activities and not their purpose.* While it cannot be doubted that in performing the [governmental capacity], CSOB was promoting the governmental policies or purposes of the State, *the activities themselves were essentially commercial rather than governmental in nature.*<sup>138</sup> (emphasis added)

Moreover, the tribunal noted that ‘CSOB took various steps to gradually throw off its exclusive economic dependence on the State and to adopt measures to enable it to function in this new economic environment as an independent commercial bank’.<sup>139</sup> Although CSOB’s lending activities were ‘driven by State policies’, the banking transactions themselves that implemented these policies ‘did not thereby lose their commercial nature’. Therefore, these activities could not be characterised as governmental in nature.<sup>140</sup>

However, the *CSOB* case has received criticisms from scholars. For example, some

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<sup>135</sup> *ibid*, para 16.

<sup>136</sup> *ibid*, para 17.

<sup>137</sup> *ibid*.

<sup>138</sup> *ibid*, para 20.

<sup>139</sup> *ibid*, para 21.

<sup>140</sup> *ibid*.

argue that the *CSOB* tribunal failed to apply the test of ‘acting as an agent for the government’ despite finding that ‘CSOB is ...an agent of the Czech Republic’.<sup>141</sup>

Most recently, an ICSID tribunal ruled on the jurisdictional objections raised by Yemen in its dispute with a Chinese SOE, BUCG.<sup>142</sup> The claim had arisen from the alleged forced deprivation of the Chinese SOE’s assets and termination of the construction contract concerning an airport project.<sup>143</sup> The respondent contended that BUCG as a Chinese SOE did not qualify as ‘a national of another Contracting State’ and the tribunal lacked jurisdiction under the ICSID Convention.<sup>144</sup> In this case, both parties accepted the *Broches* test.<sup>145</sup>

In light of the two criteria, the tribunal first held that BUCG was performing its work on the airport site under a construction contract as a commercial contractor, rather than an agent of the Chinese government.<sup>146</sup> While the respondent argued that BUCG was acting on the project as an ‘agent’ for the Chinese government because it in general was expected to ‘advance China’ national interest’ and should ‘accept the supervision and inspection’ of Chinese authorities, the tribunal held that the issue was not ‘the corporate framework of the State-owned enterprise’ but whether ‘it functions as an agent of the State in the fact-specific context’.<sup>147</sup> Moreover, the respondent itself had contended that the termination of the contract was associated with BUCG’s failure in performing its commercial services, rather than Chinese government’s decisions or policies. Also, the respondent took the position that the present dispute was an ‘ordinary garden variety commercial dispute’ which should be resolved under the relevant contract provisions.<sup>148</sup>

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<sup>141</sup> See e.g., Blyschak, ‘State-Owned Enterprises and International Investment Treaties: When Are State-Owned Entities and Their Investment Protected?’ (n 5) 37–40; Feldman, ‘The Standing of State-Owned Entities under Investment Treaties’ (n 5) 628–30.

<sup>142</sup> *BUCG* (n 6).

<sup>143</sup> *ibid*, para 25.

<sup>144</sup> *ibid*, para 29.

<sup>145</sup> In the Tribunal’s view, the *Broches* test mirrored the arbitration rules in Article 5 and 8 of the ILC’s *Articles on State Responsibility* and laid down markers for the non-attribution of state status, *ibid*, paras 33-4. Schreuer (n 106) 161.

<sup>146</sup> *ibid*, para 41.

<sup>147</sup> *ibid*, paras 37-9.

<sup>148</sup> *ibid*, para 40.



In terms of the second test, the tribunal pointed out that the ‘Respondent’s positioning of BUCG in the broad context of the PRC State-controlled economy is convincing but largely irrelevant’; also, its assertion that ‘the Chinese State is the ultimate decision maker’ for BUCG is too remote from the facts of the airport project to be relevant.<sup>149</sup> In the tribunal’s view, an appropriate focus of the function test should be placed ‘in the particular instance’, namely, the airport project, but in that capacity BUCG was not discharging a PRC government function.<sup>150</sup> In addition, the tribunal noted that the host state’s action in question (the alleged military aggression) was not by Yemen against China but in relation to BUCG as a contractor that fell down the job.<sup>151</sup>

At the time of writing, only the above two tribunals have elaborated the application of the *Broches* test. Yet, both the *CSOB* case and the *BUCG* case favour SOE investors which have confirmed that the state ownership would not disqualify a state enterprise in bringing a case before ICSID tribunals. In particular, the *BUCG* decision will be of interest to Chinese SOEs which have made significant investments abroad in a variety of economic sectors, by providing important implications that Chinese SOEs are qualified to bring claims against foreign states under the ICSID Convention. Nonetheless, whether the future tribunal will accept the *BUCG* tribunal’s interpretation remains to be seen.

Indeed, the *Broches* test *per se* is not perfect. Although Professor Schreuer has described the test as ‘probably the best guideline’ for deciding whether a state enterprise is qualified to bring a claim against another state under the ICSID Convention,<sup>152</sup> I would argue that it is merely an ambiguous directive, rather than a clear formula. According to the *Broches* test, whether an SOE has standing under the ICSID Convention is not decided by the ownership (structure) but by the function; and when determining the function, the tribunal should focus on the nature of the activities instead of the purpose.<sup>153</sup> This approach was adopted by the US Congress

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<sup>149</sup> *ibid*, paras 42-3.

<sup>150</sup> *ibid*, para 42.

<sup>151</sup> *ibid*, para 43.

<sup>152</sup> Schreuer (n 106) 161.

<sup>153</sup> *CSOB* (n 6), para 20.

in determining the commercial character of foreign state's activities for immunity exception.<sup>154</sup> Undoubtedly, such an approach has merits that it attempts to opt for a more objective standard and thus to avoid a troublesome inquiry into a state's motivation.<sup>155</sup> However, the *Broches* test does not solve the problem but leaves considerable confusion in its application.<sup>156</sup> The purpose and the nature of an activity are not absolutely separate standards, and both objective and subjective standards are necessary and vital to distinguish foreign sovereign acts from commercial activities.<sup>157</sup>

Considering that the genuine purpose of an activity conducted by a state or state entity is hard for international tribunals to discern, a more reliable assessment might be to rely on the *effect* of the activity instead of its *purpose*. Meanwhile, the definition of 'investment' could contribute to determining the *nature* of the activities. Hence, if a respondent state challenges the ICSID jurisdiction arguing that a state enterprise or state entity is not qualified to submit the case because it performs a governmental function, an appropriate and workable approach for tribunals in determining the character of the activity should be a mixed test with both subjective and objective standards.

As noted, the commercial nature of SOEs plays a central role for their qualifications for international investment protections. While the assessment on the commercial character of a SOE investor should in principle focus on its single investment, i.e., the activity of the SOE, rather than the ownership (structure) of the investor, the distinction between 'commercial' and 'non-commercial' activities of SOEs is not

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<sup>154</sup> The Foreign Sovereign Immunities Act of 1976 (FSIA) of the United States provides a most important exception for commercial activity by state. In determining the commercial character of an activity, the FSIA requires that courts to look at the *nature* of the act itself, rather than the *purpose*, see Foreign Sovereign Immunities Act of 1976, PUBLIC LAW 94-583-OCT. 21, 1976 90 STAT. 2893, 28 USC § 1603.

<sup>155</sup> Howard J Lager, 'Avoiding The "Nature-Purpose" Distinction: Redefining An International Commercial Act of State' (1997) 18 University of Pennsylvania Journal of International Law 1085, 1091.

<sup>156</sup> In fact, this test in FSIA has also been sharply criticized by commentators and courts alike, see for example, *ibid* 1101–2.

<sup>157</sup> Meanwhile, either the purpose or the nature may involve different levels. For example, the purpose of a conduct may have both a short-term and a long-term purpose. Presumably, a foreign state investing in energy industries may have a short-term purpose to make money while having a long-term purpose for energy security. Also, supposing that a state enterprise holds controlling interests in energy industries, subjectively, the act might be made on strategic or governmental considerations; but objectively, the company might make excessive profits at the same time.

always easy to clarify. Some countries have therefore proposed to oblige SOEs to more transparency to maintain a level playing field between state-owned and privately-owned entities operating on a commercial basis. For example, the EU Transparency Directive provides specific transparency requirements concerning the financial relations between public authorities and public undertakings in EU (and EEA) member states, including requiring SOEs (and other entities entrusted with public service obligations) to separate costs and assets between commercial and non-commercial accounts.<sup>158</sup> The OECD Guidelines on Corporate Governance of SOEs recommended that where SOEs combine economic activities and public policy objectives, high standards of transparency and disclosure regarding their cost and revenue structures must be maintained. Also, SOEs should disclose material financial and non-financial information...including enterprise objectives, financial and operating results, governance, ownership and voting structure of the enterprise, etc.<sup>159</sup> Although these rules and guidelines are either limited to the EU context or voluntary in nature, they can be a useful reference for policy makers to regulate SOEs in international context.<sup>160</sup>

In the current TTIP negotiations, for example, the European Parliament has recommended the Commission to include provisions on state enterprises and enterprises granted special or exclusive rights or privileges.<sup>161</sup> The EU's initial proposal for legal text on SOEs explicitly requires that SOEs shall observe high standards of transparency and corporate governance in accordance with the OECD Guidelines on corporate governance of state owned enterprises.<sup>162</sup> More importantly, the EU's proposal in respect of transparency obligations of SOEs in TTIP seems also to stress a focus on the structure the enterprise.<sup>163</sup> Similar provisions can also be

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<sup>158</sup> Commission Directive 2006/11/EC of 16 November 2006 on the transparency of financial relations between Member States and public undertakings as well as on financial transparency within certain undertakings [2006] OJ L 318/17. OECD, *Competitive Neutrality: National Practice* (OECD 2012), 41-2.

<sup>159</sup> OECD Guidelines on Corporate Governance of State-Owned Enterprises (OECD 2015).

<sup>160</sup> OECD, *State-Owned Enterprises as Global Competitors: A Challenge or An Opportunity?* (OECD 2016), 87.

<sup>161</sup> European Parliament, 'European Parliament resolution of 8 July 2015 containing the European Parliament's recommendations to the European Commission on the negotiations for the Transatlantic Trade and Investment Partnership (TTIP)' [2015] P8\_TA(2015)0252.

<sup>162</sup> Article 7.1 of the textual proposal, see the European Union's initial proposal for legal text on 'State-owned Enterprises' in TTIP (published on 7 January 2015),

<[http://trade.ec.europa.eu/doclib/docs/2015/january/tradoc\\_153030.pdf](http://trade.ec.europa.eu/doclib/docs/2015/january/tradoc_153030.pdf)> accessed 12 December 2017.

<sup>163</sup> Article 7.3 provides that each party shall make available information on SOEs, including: (a) the organisational structure of the enterprise, the composition of its board of directors... (b) the ownership and the voting structure of the enterprise...(c) a description of any special shares or special voting... (d) the name and

found in the EU proposal for a legal text in the EU-Indonesia FTA.<sup>164</sup> Nonetheless, the application of these rules for SOEs remains to be tested in practice.

In addition, the International Working Group of Sovereign Wealth Funds (IWG) issued the Santiago Principles to identify a framework of generally accepted principles and practices that properly reflect appropriate governance and accountability arrangements as well as the conduct of investment practice by SWFs on a prudent and sound basis.<sup>165</sup> Specifically, under the Santiago Principles 1.2, the key features of the SWF's legal basis and structure, as well as the legal relationship between the SWF and other state bodies, should be publicly disclosed. The Principles 19 requires that SWF's investment decisions should 'aim to maximize risk-adjusted financial returns in a manner consistent with its investment policy, and based on economic and financial grounds'; if investment decisions are subject to other than economic and financial considerations, these decisions 'should be clearly set out in the investment policy and be publicly disclosed'.<sup>166</sup>

The transparent rules for SOEs in new generations of IIAs and the Santiago Principles have indicated countries' efforts to stress commercial objectives of SOEs and SWF activities and call for greater transparency on the enterprises and funds to ensure they conduct commercial activities in the international marketplace. Although it is possible for future treaties to incorporate the principles of good governance and transparency, a notable feature of the current international investment regime is an absence of binding investor obligations. In fact, SOEs' obligations of corporate government and transparency can be addressed either through national and supranational laws or through non-binding international guidelines. Nonetheless, developed states may be willing to provide binding rules on SOEs' obligations in international treaties for two reasons: first, enterprises from developed countries, whether publicly or privately owned, have already been subject to higher obligations

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title(s) of any government official serving as official or member of the board... (e) details of the government departments or public bodies... (f) the role of the government of any public bodies in the appointment, dismissal or remuneration of managers...

<sup>164</sup> See European Union's proposal for a legal text on state-owned enterprises, enterprises granted special rights or privileges, and designated monopolies in the EU-Indonesia FTA (published on 19 December 2016) <[http://trade.ec.europa.eu/doclib/docs/2017/february/tradoc\\_155286.pdf](http://trade.ec.europa.eu/doclib/docs/2017/february/tradoc_155286.pdf)> accessed 19 December 2017.

<sup>165</sup> IWG, Sovereign Wealth Funds: Generally Accepted Principles and Practices "Santiago Principles" (2008) <[http://www.ifswf.org/sites/default/files/santiagoprinciples\\_0\\_0.pdf](http://www.ifswf.org/sites/default/files/santiagoprinciples_0_0.pdf)> accessed 19 December 2017.

<sup>166</sup> *ibid.*

on corporate governance and transparency than SOEs from developing countries; second, SOEs from developing countries have been assumed to be driven by political objectives and thus the developed host countries are more eager to assess the possibly political interference in the operation of SOE investments.

## 2.4 SOE Investments as Protected ‘Investments’

This section turns to another important issue of whether SOE investments are covered as qualified ‘investments’ under investment treaties, or whether ‘state ownership disqualifies an SOE investment as a protected ‘investment’.

### 2.4.1 SOE Investments under the ‘Investment’ Definition

As a key term and prerequisite issue in international investment law, almost all investment treaties define what constitute an ‘investment’.<sup>167</sup> Most of the treaties typically provide a very broad asset-based definition of ‘investment’ with an illustrative list of investment forms.<sup>168</sup> For example, the Germany-Malaysia BIT defines that:

The term ‘investment’ shall comprise every kind of asset and more particularly, though not exclusively:

- (a) movable and immovable property as well as any other rights in rem...;
- (b) shares or other kinds of interests in company;
- (c) title to money or to any performance having an economic value.<sup>169</sup>

Under this formulation of investment definition, the specific categories of investments are merely provided as examples. Hence, even if an alleged investment is not specifically included in the list of assets, it may still enjoy investment protections.<sup>170</sup> By contrast, some treaties provide an exhaustive list of assets that are

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<sup>167</sup> Sornarajah (n 4) 190.

<sup>168</sup> Vandevelde, *Bilateral Investment Treaties: History, Policy, and Interpretation* (n 21) 122.

<sup>169</sup> Article 1 (1) of the Germany-Malaysia BIT (1960).

<sup>170</sup> *Siemens A.G. v. The Argentine Republic*, Decisions on Jurisdiction, 3 August 2004 (ICSID Case No. ARB/02/8), para 137. Salacuse JW, *The Law of Investment Treaties* (OUP 2015), 178.

covered by the ‘investment’, such as the China-Canada BIT.<sup>171</sup> While an exhaustive list seems to limit the coverage of covered investments, the definition of investment is usually still broad enough to include all the major investments currently employed by investors.<sup>172</sup> While the language of investment definitions differs among investment treaties, there is no distinction between public and private investments.

A feature of SOE investments is, obviously, that they are state-owned, i.e., the investments are funded or financed by states or state entities. According to the above broad definition of ‘investments’, however, whether a foreign investment is financed by a foreign government or public entity seems to be irrelevant to the existence of a qualified ‘investment’ since they are not part of the definition clause.<sup>173</sup> In *Tokios*

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<sup>171</sup> Article 1 (1) of the China- Canada BIT (2012) provides:

**investment** means:

- (a) an enterprise;
  - (b) shares, stocks and other forms of equity participation in an enterprise;
  - (c) bonds, debentures, and other debt instruments of an enterprise;
  - (d) a loan to an enterprise
    - (i) where the enterprise is an affiliate of the investor, or
    - (ii) where the original maturity of the loan is at least three years;
  - (e) notwithstanding sub-paragraphs (c) and (d) above, a loan to or debt security issued by a financial institution is an investment only where the loan or debt security is treated as regulatory capital by the Contracting Party in whose territory the financial institution is located;
  - (f) an interest in an enterprise that entitles the owner to share in the income or profits of the enterprise;
  - (g) an interest in an enterprise that entitles the owner to share in the assets of that enterprise on dissolution;
  - (h) interests arising from the commitment of capital or other resources in the territory of a Contracting Party to economic activity in such territory, such as under
    - (i) contracts involving the presence of an investor’s property in the territory of the Contracting Party, including turnkey or construction contracts, or concessions to search for and extract oil and other natural resources, or
    - (ii) contracts where remuneration depends substantially on the production, revenue or profits of an enterprise;
  - (i) intellectual property rights; and
  - (j) any other tangible or intangible, moveable or immovable, property and related property rights acquired or used for business purposes;
- but ‘investment’ does not mean:
- (k) claims to money that arise solely from
    - (i) commercial contracts for the sale of goods or services, or
    - (ii) the extension of credit in connection with a commercial transaction, such as trade financing, other than a loan covered by sub-paragraph (d); or
  - (l) any other claims to money,
- that do not involve the kinds of interests set out in sub-paragraphs (a) to (j);

<sup>172</sup> Salacuse (n 170) 184.

<sup>173</sup> Annacker (n 5) 543.

*Tokelės v. Ukraine*, for instance, the tribunal held that neither the text of the definition of ‘investment’, nor the context in which the term is defined allowed an ‘origin-of-capital’ requirement to be implied.<sup>174</sup> Furthermore, the tribunal also noted that the ‘origin-of-capital’ requirement was ‘inconsistent with the object and purpose of the Treaty, which... [was] to provide broad protection to investors and their investment in the territory of either party’.<sup>175</sup> Likewise, the *Saipem v. Bangladesh* tribunal also noted that ‘the origin of the funds [was] irrelevant’ according to the drafting history of the ICSID Convention and several arbitral decisions relating to BITs.<sup>176</sup> Therefore, under the commonly adopted definitions of ‘investments’, SOE investments are covered as protected investments.

Nonetheless, some may argue that SOE investments are not purely commercially motivated, so that they are not qualified as ‘investments’.<sup>177</sup> However, the motivation of foreign investors in making an investment is not relevant to the definition of ‘investments’ under IIAs either. As the *Saluka* tribunal stated, ‘even if it were possible to know an investor’s true motivation in making its investment, nothing in [the investment definition clause] makes the investor’s motivation part of the definition of an investment’.<sup>178</sup> In *Tatneft v. Ukraine*,<sup>179</sup> the tribunal refused to read additional requirements into the BIT’s definition of investment or to enter into an

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<sup>174</sup> *Tokios Tokelės v. Ukraine*, ICSID Case No. ARB/02/18, Decision on Jurisdiction, 29 April 2004, para 77. Article 1 (1) of the Lithuania- Ukraine BIT (1994) provides that, ‘The term “investment” shall comprise every kind of asset invested by an investor of the Contracting Party in the territory of the other Contracting Party in accordance with the laws and regulations of the latter and shall include, in particular, though not exclusively...’

<sup>175</sup> *ibid.*

<sup>176</sup> *Saipem S.p.A. v. The People's Republic of Bangladesh*, ICSID Case No. ARB/05/07, Decision on Jurisdiction, 21 Mar 2007, para 106.

<sup>177</sup> For example, some suspect that SOE investments are motivated by non-commercial considerations, such as seeking critical energy and resources or implementing a state’s political aims or strategic policies.

<sup>178</sup> *Saluka Investments B.V. v. The Czech Republic*, UNCITRAL, Partial Award, 17 March 2006, para 206. Article 1(a) of the Czech Republic-Netherlands BIT (1991) provides that, ‘investments shall comprise every kind of asset invested either directly or through an investor of a third State and more particularly, though not exclusively...’

<sup>179</sup> The claim was brought by a Russian oil company, OJSC Tatneft, against Ukraine under the Russian Federation-Ukraine BIT (1998). In the case, the tribunal held that Tatneft was not controlled by the Republic of Tatarstan, so there was no need to decide or prejudge whether public entities are allowed to claim under the Russia-Ukraine BIT. Notably, the full jurisdictional decision has not been published until now; information discussed here is from the IARepporter that obtained a copy of the September 28, 2010 partial award on jurisdiction after Tatneft initiated additional enforcement proceedings in London and in Russia. For more analysis see Damien Charlotin, ‘PREVIOUSLY-UNSEEN JURISDICTIONAL AWARD WAVES AWAY OBJECTIONS TO RUSSIAN-OWNED INVESTMENT CLAIM’ (n 65).

examination of the motives of the investment.<sup>180</sup> In the tribunal's view, while the investment had both public and private purposes, this could be attributed to 'the transition period between the command economies of the past and the market economies of the present'; ultimately, Tatneft's activities were 'in their essence, commercially-oriented', which was enough to qualify as an investment under the BIT. Some scholars argue that the political motivation of a particular sovereign investment may be questionable but it should not affect the jurisdiction of ICSID.<sup>181</sup>

However, it is notable that some investment treaties expressly provide that 'investments' shall comprise any kinds of assets invested in connection with economic activities.<sup>182</sup> Under such a definition, an asset that is qualified as 'investment' for treaty protections is required to be economic activities or commercial in nature. Accordingly, an SOE investment might not be considered as a qualified 'investment' if it did not have a commercial intention (e.g., not for making profit) or engaged in non-commercial activities (e.g., political espionage). In *Phoenix Action v. Czech Republic*, for instance, the tribunal held that 'if the sole purpose of an economic transaction is to pursue an ICSID claim, without any intent to perform any economic activities in the host country, such transaction cannot be considered as a protected investment'.<sup>183</sup> However, the intention of a foreign SOE investment is a very controversial and complicated issue. On the one hand, it is hard for a tribunal to discern the genuine purpose of a foreign SOE in making an investment; on the other

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<sup>180</sup> *ibid.* Article 1 (1) of the Russian-Ukraine BIT provides:

'Investments' shall denote all kinds of property and intellectual values, which are put in by the investor of one Contracting Party on the territory of the other Contracting Party in conformity with the latter's legislation, and in particular:

- a) movable and immovable property and any other rights of property therein;
- b) monetary funds and also securities, liabilities, deposits and other forms of participation;
- c) rights to objects of intellectual property, including authors' copyrights and related rights, trade marks, the rights to inventions, industrial samples, models and also technological processes and know-how;
- d) rights to perform commercial activity, including rights to prospecting, development and exploitation of natural resources.

No alteration of the type of investments, which the funds are put in, shall affect their nature as investments, unless such alteration is contrary to the laws of a Contracting Party on whose territory the investments were made.

<sup>181</sup> Mathias Audit, 'Is the Erecting of Barriers against Sovereign Wealth Funds Compatible with International Investment Law?' (2009) 10 *The Journal of World Investment and Trade* 617, 626; Annacker (n 5) 543.

<sup>182</sup> See e.g., Czech Republic-Israel BIT (1997), Article 1 (1); Belarus-Czech Republic BIT (1996), Article 1; NAFTA (1992), Article 1139; etc.

<sup>183</sup> *Phoenix Action, Ltd. v. The Czech Republic*, ICSID Case No. ARB/06/5, Award, 15 April 2009, paras 93, 144.



hand, SOE investments may have both commercial and non-commercial purposes. In this context, tribunals are strongly advised to make a thorough review on a case-by-case basis, especially focusing on the activity or transaction *itself*, rather than just the motivation, to determine whether it is commercial or economic in essence.

#### 2.4.2 SOE Investments with Characteristics of ‘Investments’: ‘*Salini* test’ under the ICSID Convention

Despite the above discussion, a more complex issue in relation to SOE investments may arise out of the undefined ‘investment’ under the ICSID Convention for jurisdiction.<sup>184</sup> In fact, how to interpret ‘investment’ under Article 25 of the ICSID Convention has long been debated in arbitral practice and by the scholars.<sup>185</sup> However, it is still necessary to address this issue for two main reasons. Firstly, some tribunals’ interpretation may disqualify the SOE investment for jurisdiction *ratione materiae* under the ICSID Convention. When assessing the existence of investment under the ICSID Convention, many tribunals have relied on the ‘*Salini* test’ which defines an investment as having four elements: (1) a contribution of money or assets; (2) a certain duration; (3) an element of risk; and (4) a contribution to the economic development of the host state.<sup>186</sup>

Regardless of tribunals’ divergence on this test, it is notable that these elements may have implications on SOE investments if a tribunal considers them as necessary

<sup>184</sup> According to Article 25 (1) of the ICSID Convention, the jurisdiction of the Centre shall extend to any legal dispute arising directly out of an investment. This article serves as the jurisdictional gateway for access to ICSID arbitration. Dolzer and Schreuer (n 10) 65.

<sup>185</sup> See *generally*, e.g., Mavluda Sattorova, ‘Definition Investment Under the ICSID Convention and BITs: Of Ordinary Meaning, Telos, and Beyond’ (2012) 2 Asian Journal of International Law 267; Emmanuel Gaillard, ‘Identify or Define? Reflections on the Evolution of the Concept of Investment in ICSID Practice’ in Christina Binder and others (eds), *International Investment Law for the 21st Century: Essays in Honour of Christoph Schreuer* (OUP 2009); Emmanuel Gaillard and Yas Banifatemi, ‘The Long March Towards A Jurisprudence Constante on the Notion of Investment’ in Meg Kinnear and others (eds), *Building International Investment Law: The First 50 Years of ICSID* (Kluwer Law International 2016); Alex Grabowski, ‘The Definition of Investment under the ICSID Convention: A Defense of Salini’ (2014) 15 Chicago Journal of International Law 289; Julian Davis Mortenson, ‘The Meaning of “Investment”: ICSID’s Travaux and the Domain of International Investment Law’ (2010) 51 Harvard International Law Journal 257; Joseph M Boddicker, ‘Whose Dictionary Controls?: Recent Challenges to the Term “Investment” in ICSID Arbitration’ (2010) 25 American University International Law Review 1031; Dolzer and Schreuer (n 10) 65-76; Salacuse (n 170) 196-200.

<sup>186</sup> *Salini Costruttori S.p.A. and Italstrade S.p.A. v. Kingdom of Morocco*, ICSID Case No. ARB/00/4, Decision on Jurisdiction, 31 July 2001; English translation see 42 ILM 609 (2003), 6 ICSID Rep 400 (2004), para 52.

elements of constituting an investment. The first two criteria are less problematic: there is no requirement for the sources of the contribution, such as whether or not it is made by a foreign state;<sup>187</sup> and there is no difference between public and private investments in respect of duration. Some may argue that the SOE investment lacks risks because it is backed by a sovereign state. Here, it does not matter who ultimately takes the risk of investment - either a corporation or a state, and whether or not the risk has occurred already.<sup>188</sup> But, ordinary commercial transactions such as sales contracts are likely to be disqualified as investments under the ICSID Convention.<sup>189</sup> Hence, some scholars argue that ICSID tribunals have no jurisdiction on sovereign bonds regardless of their values.<sup>190</sup>

The most controversial element is the ‘contribution to the host state’s development’.<sup>191</sup> The *CSOB* tribunal pointed out that the language in the Convention’s Preamble suggested that an international transaction as an investment had to promote a state’s economic development.<sup>192</sup> However, many scholars and tribunals consider that this subjective element is perceived as being unnecessary.<sup>193</sup> Moreover, some tribunals noted that the element of ‘contribution to the economic development’ was difficult to establish and was already implicit in other three elements.<sup>194</sup> Furthermore, contribution to economic development might well be a

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<sup>187</sup> For example, Mr. Broches said that he did not see how the Convention could make a distinction based on the origin of funds, see ICSID (n 115) 261.

<sup>188</sup> Usually, the element of risk is merely the assumption of risk.

<sup>189</sup> See, e.g., *Malaysian Historical Salvors, SDN, BHD v. The Government of Malaysia*, ICSID Case No. ARB/05/10, Award on Jurisdiction, 19 February 2009, para 112; *Joy Mining Machinery Limited v. Arab Republic of Egypt*, ICSID Case No. ARB/03/11, Award on Jurisdiction, 6 August 2004, para 57. See also Schreuer (n 106) 89.

<sup>190</sup> Michael Waibel, ‘Opening Pandora’s Box: Sovereign Bonds in International Arbitration’ (2007) 101 *American Journal of International Law* 711, 718–32.

<sup>191</sup> Schreuer (n 106) 131.

<sup>192</sup> *CSOB* (n 6) paras 64, 88.

<sup>193</sup> As noted, the Preamble’s reference to ‘the need for international cooperation for economic development, and the role of private investment therein’ appears to be a mere acknowledgement that investment fosters economic development, Gaillard and Banifatemi (n 185) 119.

<sup>194</sup> See e.g., *LESI, S.p.A. and Astaldi, S.p.A. v. People’s Democratic Republic of Algeria*, ICSID Case No. ARB/05/3, Award, 12 November 2008, para 72; *Saba Fakes v. Republic of Turkey*, ICSID Case No. ARB/07/20, Award, 14 July 2010, para 111; *Quiborax S.A., Non Metallic Minerals S.A. and Allan Fosk Kaplun v. Plurinational State of Bolivia*, ICSID Case No. ARB/06/2, Decision on Jurisdiction, 27 September 2012, para 221; *KT Asia Investment Group B.V. v. Republic of Kazakhstan*, ICSID Case No. ARB/09/8, Award, 17 October 2013, para 5.43.

consequence of an investment, rather than an essential component of the notion.<sup>195</sup> To date, the case law in respect of this criterion is still very contentious. Yet, considering that SOE investments are sometimes viewed with suspicion, such as threatening to national security interests or distorting market competition in some Western countries, it may be possible for host states to challenge ICSID jurisdictions for SOE investment disputes by disqualifying the SOE investment on the basis of contributing to economic development.

In the author's view, nonetheless, foreign investments, whether publicly or privately owned, may have positive impacts on host states (such as contributing to the GDP or increase employment opportunities) as well as negative impact (such as disrupting the local environment and other public interests, or corruption). Hence, the contribution to the host state's development should be treated as a sufficient rather than a necessary element of investment, and tribunals should assess this with particular care.<sup>196</sup> While such a contribution to development is an object and purpose of foreign investments, the actual impact of the SOE investment in the host state warrants closer attention.<sup>197</sup> For practical reasons, a 'positive/negative impact' criterion might be a preferable approach, i.e., if an SOE investment did not harm the host state's development it should be deemed to satisfy the requirement. As Schreuer stated, it does not follow from the test that 'an activity that does not obviously contribute to economic development must be excluded from the Convention's protection'.<sup>198</sup>

The second reason to address the ICSID jurisprudence on 'investment' under Article 25 is that the criteria established in arbitral practice are considered to focus on the economic nature of the investment, which could be used to distinguish investment activities by state entities from a sovereign acting in its governmental capacity. Despite the divergence on the '*Salini* test', the case law is progressively evolving towards a greater recognition of an objective requirement under Article 25 of the

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<sup>195</sup> *Quiborax* (n 194) para 220; *Alpha Projektholding GmbH v. Ukraine*, ICSID Case No. ARB/07/16, Award, 8 November 2010, para 312.

<sup>196</sup> Schreuer (n 106) 134.

<sup>197</sup> Waibel (n 190) 724.

<sup>198</sup> Schreuer (n 106) 134.

ICSID Convention and an economic concept of investment - the ordinary meaning of the word.<sup>199</sup> Specifically, many tribunals have acknowledged that the objective definition of investment under the ICSID Convention comprises three elements of contribution of money or assets, risk and duration.<sup>200</sup> These elements focus on the ‘characteristics’ of investment, rather than the ownership of the investment and the purpose of the activity. Accordingly, only genuine investments that have the characteristics of investments are protected under the ICSID Convention. Therefore, in determining whether an SOE investment qualifies for investment protections, the tribunal can rely on the characteristics of investment to ensure that the activity by a state entity is commercial or economic in nature.

Indeed, some investment treaties expressly define protected investments as assets with the characteristics of an investment. This is typical in the US BIT practice. For example, the 2012 US Model BIT provides that ‘investment’ means ‘every asset that an investor owns or controls, directly or indirectly, that has the characteristics of an investment, including such characteristics as the commitment of capital or other resources, the expectation of gain or profit, or the assumption of risk’.<sup>201</sup> The 2009 ASEAN Comprehensive Investment Agreement provides in a footnote that, ‘[w]here an asset lacks the characteristics of an investment, that asset is not an investment regardless of the form it may take’.<sup>202</sup> In light of these treaty provisions, SOE investments have to satisfy these characteristics of investment for qualification as an investment under the investment treaty.

It is notable that the listed characteristics of investment in treaties are not exactly the same as that in ICSID jurisprudence. Nonetheless, the characteristics of investment provided in treaties are normally non-exhaustive with reference to ‘including’; thus, other characteristics of an investment, such as the element of duration, might also

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<sup>199</sup> Gaillard and Banifatemi (n 185) 124.

<sup>200</sup> For example, see *Quiborax* (n 194) para 227.

<sup>201</sup> Article 1 of the US 2012 Model BIT. Similar provisions see also Article 9.1 (d) of the Australia-China FTA (2015), Article 12.1 of the China-Republic of Korea FTA (2015), Article 1(1) of the China-Japan-Korea trilateral investment agreement (2011), etc.

<sup>202</sup> Further, the Agreement provides that, ‘[t]he characteristics of an investment include the commitment of capital, the expectation of gain or profit or the assumption of risk’.

have to be satisfied for an SOE investment to be covered by the treaty.<sup>203</sup> A problem may arise in respect of ‘the expectation of gain or profit’. Some may argue that SOE investments are driven by non-commercial motivations so that they do not have expectations of gain or profit. Here, it is necessary to address the fact that an expectation of profit does not mean that investment is profitable or has made profits. Nonetheless, this element may exclude some assets of SOEs as qualified investments and limit the protected SOE investments to those made on a commercial basis.<sup>204</sup>

#### 2.4.3 SOE Investments in accordance with Host State’s Legislation

Another interesting issue concerning SOE investments is the legality requirement. In contrast to US treaties, most of the investment treaties signed by European countries explicitly define that investments are assets made or invested in accordance with laws and regulations of the host state.<sup>205</sup> Likewise, the Investment Agreement for the COMESA Common Investment Area provides that ‘investment’ means ‘assets admitted or admissible in accordance with the relevant laws and regulations of the COMESA Member State in whose territory the investment is made’.<sup>206</sup> Also, the ‘in accordance with host state’s laws and regulations’ is the only generally applied qualification on the definition of investment in Chinese BITs.<sup>207</sup> This requirement can, on the one hand, limit the broad coverage of investments; and on the other hand, ensure that foreign investors observe the host state’s laws and regulations.<sup>208</sup> More importantly, the ‘in accordance with the host state’s law’ requirement reserves certain regulatory space for the host state to ensure that an investment is covered only if it is consistent with the national legislation, even after the investment is made.

The legality requirement has important implications for foreign SOE investments.

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<sup>203</sup> Salacuse (n 170) 182.

<sup>204</sup> It is notable that the characteristics of investment provided in investment treaties are considered as examples, which implies that they are not required to be satisfied cumulatively. In other words, a SOE asset that lacks the expectation of profits is not necessarily disqualified as a protected investment under the treaty.

<sup>205</sup> See e.g., Article 1 (1) of the Germany-Philippines BIT (1997).

<sup>206</sup> Article 1 (9) of the Investment Agreement for the COMESA Common Investment Area (2007).

<sup>207</sup> Norah Gallagher and Wenhua Shan, *Chinese Investment Treaties: Policy and Practice* (Oxford University Press 2009), para 2.05. Notably, some Chinese treaties such as the 2003 Germany BIT and 2004 Uganda BIT have removed the requirement from the definition of investment clause.

<sup>208</sup> Salacuse (n 170) 184.

With this limitation, a host state, and ultimately a tribunal, may deny treaty protection to an SOE investment that is found not to be in compliance with the host state's national law. As noted in the previous chapter, an increasing number of states have enacted or amended legislation to strengthen regulations on SOE investments.<sup>209</sup> In this context, SOE investors are recommended to observe domestic regulations carefully and to ensure that their investments are consistent with host state laws. If an SOE has failed to comply with local laws, the tribunal may deny the jurisdiction over the claim by the SOE since its investment is not protected under the applicable treaty; and obviously, the host state will not be liable for compensation on the merits of the SOE's claim.

However, it may be controversial whether an SOE investment in question is legal or not. On the one hand, national law and regulations in respect of SOE investments differ among countries. The next chapter will elaborate the national legislation in respect of SOEs in selected countries. Notably, some treaties remove the 'in accordance with host state law' requirement from the provision of investment definition to the provision of promotion and admission,<sup>210</sup> while some include the legality requirement in both definition and admission clauses.<sup>211</sup> It is necessary to address here that the legality requirement in different provisions may have different implications for SOE investments. If the treaty provides the legality requirement in the investment definition clause, this limitation is a jurisdictional prerequisite. Accordingly, a foreign SOE can pursue a claim only if its investment is in accordance with the host state's law. Also, an international tribunal can dismiss the jurisdiction for an SOE investment if it is found to be illegal. By contrast, if the

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<sup>209</sup> See also Ch 3.

<sup>210</sup> For example, the China-Germany BIT (2003) does not provide the 'in accordance with local laws' in the definition of 'investment' (Article 1 (1): the term 'investment' means every kind of asset invested directly or indirectly by investors of one Contracting Party in the territory of the other Contracting Party), but includes this limitation in the provision of promotion and protection of investment (Article 2 (1): Each Contracting Party shall encourage investors of the other Contracting Party to make investments in its territory and admit such investments in accordance with its laws and regulations).

<sup>211</sup> For example, the Germany-Philippines BIT (1998) provides the legality requirement in both the definition of investment clause (Article 1 (1): the term 'investment' shall mean any kind of asset accepted in accordance with the respective laws and regulations of either Contracting State), and the clause of promotion and acceptance (Article 2 (1) (1): Each Contracting State shall promote as far as possible investments in its territory by investors of the other Contracting State and admit such investments in accordance with its Constitution, laws and regulations as referred to in Article 1 paragraph 1).

legality requirement is merely found in the admission or promotion provision under an applicable treaty, an SOE investor that has failed to comply with host state's law can still pursue a claim and should not be excluded from the tribunal's jurisdiction, although the tribunal may deny the substantive protections for the SOE investments due to the illegality in the merits phase.<sup>212</sup>

On the other hand, the issue of the legality requirement on investment bears various debates, and the tribunals' interpretations are inconsistent.<sup>213</sup> In particular, it is problematic which host state law investors have to comply with.<sup>214</sup> For example, some tribunals held that investments would be excluded from BIT protections when made in breach of 'fundamental principles' of the host state's law,<sup>215</sup> while many other tribunals did not mention or assume that the host state law was limited to fundamental principles.<sup>216</sup> Furthermore, some tribunals indicated that the principle of good faith and international public policy (such as fraud and corruption) were involved in the legality requirement.<sup>217</sup> Moreover, some tribunals held that the legality requirement was limited only to laws 'governing the admission of investments in the host state',<sup>218</sup> while some tribunals considered that other domestic laws such as contract law, criminal law and competition law in relation to investment

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<sup>212</sup> See *Inceysa Vallisoletana S.L. v. Republic of El Salvador*, ICSID Case No. ARB/03/26, Award, 2 August 2006, para 153. See also Lu Wang, 'The "In Accordance with Local Laws" Requirement in BITs: Implications for the China-US BIT Negotiations' (2013) 30 *Studies in Law and Business* 120, 121–2.

<sup>213</sup> See generally, e.g., Salacuse (n 170) 184–8; Rahim Moloo and Alex Khachaturian, 'The Compliance with the Law Requirement in International Investment Law' (2011) 34 *Fordham International Law Journal* 1473; Jean Kalicki, Dmitri Evseev and Mallory Silberman, 'Legality of Investment' in Meg Kinnear and others (eds), *Building International Investment Law: The First 50 Years of ICSID* (Kluwer Law International 2016).

<sup>214</sup> For further discussion see Jarrod Hepburn, 'In Accordance with Which Host State Law? Restoring the Defence of Investor Illegality in Investment Arbitration' (2014) 5 *Journal of International Dispute Settlement* 531, 531–59; Wang, 'The "In Accordance with Local Laws" Requirement in BITs: Implications for the China-US BIT Negotiations' (n 212) 120–6.

<sup>215</sup> See e.g., *LESI* (n 194), para 83; *Desert Line Projects LLC v. Yemen*, ICSID Case No ARB/05/17, Award, 6 February 2008, para 104; *Rumeli* (n 131), para 319.

<sup>216</sup> In particular, the *Quiborax* tribunal explicitly rejected the fundamental principles limitation; the tribunal considered that interpretation was 'too narrow', going 'beyond the terms of the BIT, in an attempt to further the investor's protection without due regard for the state's interests', *Quiborax* (n 194) Decision on Jurisdiction (ICSID Case No ARB/06/2), para 263. See Hepburn (n 214) 536–9.

<sup>217</sup> See e.g., *Inceysa* (n 212), paras 237 & 245; *Phoenix Action* (n 183), paras 100 & 106-7; *Hamester* (n 84), para 123; *Teinver S.A., Transportes de Cercanías S.A. and Autobuses Urbanos del Sur S.A. v. The Argentine Republic*, ICSID Case No. ARB/09/1, Decision on Jurisdiction, 21 December 2012, para 317.

<sup>218</sup> See e.g., *Saba Fakes* (n 194), para 119.

might be considered as well.<sup>219</sup> As a result, there exists a risk that tribunals may have different conclusions on whether or not an SOE investment is in accordance with the host state's law.

It is not intended to discuss here the proper interpretation of the legality requirement. Rather, it is necessary to note that compliance with local laws is crucial to enable the host state to protect its national interests from being affected by foreign SOE investments. As the *Anderson v. Costa Rica* tribunal held that, '[t]he assurance of legality on investment has important, indeed crucial, consequences for the public welfare and economic well-being of any country'.<sup>220</sup> In recent years, some countries have enacted or amended their national legislation on SOE investments to protect national security or address other public policies. Nevertheless, such regulations are the domestic legal regime for SOE investors where a breach of law would not result in any consequences at the international law level. However, if investment treaties contain a requirement that investments subject to treaty protections must be in compliance with the host state's law, it will effectively impose an international obligation on SOE investors to ensure that their investments must be made legally in the host state, such as satisfied the national security review or obtained approvals from authorities. For example, the *Anderson* tribunal pointed out that, the words 'in accordance with the laws' reflected both sound public policy and sound investment practices, and the prudent investment practice required that 'any investor exercise due diligence before committing funds to any particular investment proposal'.<sup>221</sup> Accordingly, a tribunal might dismiss the jurisdiction on the ground that the SOE investor did not exercise due diligence in assuring that their investments were in accordance with the host state's law.

The result would be a big advantage for states in regulating SOE investments: while a host state's action or measure against an SOE investment violates substantive obligations under investment treaties such as non-discriminatory treatment or fair

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<sup>219</sup> Hepburn (n 214) 548–9.

<sup>220</sup> *Alasdair Ross Anderson et al v. Republic of Costa Rica*, ICSID Case No. ARB (AF)/07/3, Award, 19 May 2010, para 53.

<sup>221</sup> *ibid*, para 58.



and equitable treatment,<sup>222</sup> the state might not be liable for compensation on the merits of the SOE investor's claim if the SOE investor failed to comply with the host state's law - because the claim falls outside the tribunal's jurisdiction. In this context, states that have concerns over SOE investments are advised to include the 'in accordance with host state law' requirement in the definition of investment in their treaties; meanwhile, SOE investors are advised to exercise due diligence when making and operating an investment. As mentioned earlier, some countries have required greater obligations of transparency for SOEs operating in commercial activities. In such cases, if an SOE investor fails to disclose information required by host state's laws, the SOE may be disqualified for international investment protections.

## 2.5 Concluding Remarks

Both the definition of 'investor' and that of 'investment' are highly contested issues in international investment law. Based on the discussions made above, most of the investment treaties do not explicitly exclude SOEs from the definition of investor, while some treaties explicitly define state enterprises and even states as 'investors'. Meanwhile, most of the investment treaties provide a broad and open-ended asset-based definition of investment where neither the origin of capital nor the motivation of the investor is relevant to the qualification of an investment. Accordingly, SOEs are in principle qualified for investment protections. However, investment treaties are not always clear on the standing of SOEs, and international tribunals are not consistent on how to interpret the investor and investment provisions. As a result, whether or not an SOE is qualified as an 'investor' and whether an SOE investment is a protected 'investment' are still controversial questions.

What is clear now is that the issue of whether SOEs are qualified for international investment protections, especially whether an SOE can resort to the ICSID arbitration, is likely to be subject to increasing scrutiny and debate. With the worldwide increase in sovereign investments and state protectionist measures against

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<sup>222</sup> For more discussion see Ch 4.

these investments, sovereign investors may increasingly use international investment arbitration to seek protection in the future.<sup>223</sup> In 2015, for example, the Ukrainian state-owned bank, Oschadbank, filed a claim worth UAH 15 billion against Russia for losses caused by the Crimea annexation under the Ukraine-Russia BIT.<sup>224</sup> This arbitration is described as ‘the first of a possible wave of BIT claims’ by Ukrainian SOEs against Russia.<sup>225</sup> Likewise, BUCG’s success in the jurisdiction decision may inspire other Chinese SOEs to bring claims at ICSID in the face of expropriatory or adverse regulatory measures taken by host states.

If so, whether SOEs are qualified for investment protections would be inevitably discussed by international tribunals. However, the problem is that most of the old generation BITs, including both the Ukraine-Russia BIT and the China-Yemen BIT, are silent on whether an SOE is a qualified investor, whilst it is uncertain whether and how the tribunal would consider the SOE as ‘a national of a Contracting State’ under Article 25 of the ICSID Convention even on the same basis of a ‘*Broches test*’. Hence, there is a risk that SOEs are dismissed to bring a claim against host states in international arbitrations.

When the investment treaties are silent on SOEs, arbitrators would have considerable discretion to determine whether SOEs enjoy international investment protections. Some scholars thus doubt that international investment arbitration is a feasible way to ‘de-politicise’ investment disputes brought by investors with a connection to their government against another government.<sup>226</sup> However, it is not uncommon in recent years that foreign governments are actively engaged in economic activities. In such a case, a proper examination of whether the state or SOE is a qualified investor for

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<sup>223</sup> Burgstaller (n 8) 177.

<sup>224</sup> ‘Oschadbank files claim worth UAH 15 bln against Russia for losses caused by Crimea annexation – Yatseniuk’ *Interfax-Ukraine* (8 July 2015) <<http://en.interfax.com.ua/news/economic/276618.html>> accessed 5 April 2017. The case is still pending.

<sup>225</sup> After Oschadbank brought the case to PCA, Ukrainian Prime Minister Arseniy Yatseniuk publicly urged ‘all other Ukrainian state-run companies to follow the example of state-owned Oschadbank of Ukraine to make Russia accountable and recover losses caused by the illegal annexation of Crimea from Russia’, Luke Eric Peterson, ‘In the first of a possible wave of BIT claims by Ukraine state-owned entities against Russia, an UNCITRAL tribunal is finalized’ *IAReporter* (14 August 2016) <<http://tinyurl.com/zshatgl>> accessed 9 September 2017.

<sup>226</sup> Poulsen, ‘States as Foreign Investors: Diplomatic Disputes and Legal Fictions’ (n 8) 17–8.

treaty protections, i.e., whether it exercises commercial or governmental functions, should focus on the specific instance of its behaviours, rather than ownership. To some extent, excluding sovereign investors from investment protections - especially international arbitrations merely on the basis of state ownership - will be a disguised form of 'politicising' the investment dispute.

Nonetheless, it is still advisable to revise investment treaties to make them clear on SOE investments. In other words, whether or SOEs are qualified for investment protections should ultimately be determined by contracting states through the language adopted in investment treaties concluded by them. Obviously, a clear and explicit inclusion of SOEs would guarantee their international protections. This implication is of great importance to countries with large interests in SOE investments. In addition, some treaties have expressly included not only SOEs but also states as qualified investors, which could provide an additional guarantee for SOEs to be covered by investment protections.

Although SOE investments should be qualified for investment protections in principle, it is also necessary to set limitations to prevent SOEs from misusing or abusing treaty protections. The definition of investment can play a role in achieving this goal. Regardless of the divergence in arbitral practice, an inclusion of 'characteristics of investment' in the definition addresses the economic or commercial nature of an investment, which can be used to distinguish genuine investment by SOEs in commercial capacity from other activities by SOEs in a governmental capacity. Moreover, the 'in accordance with host state's law' requirement in the definition of investment has an important implication for securing national legal regime and protecting national interests. With this limitation, a host state will have more discretion in regulating SOE investments, and the tribunal can dismiss the jurisdiction over the claim by SOE investor that has failed to comply with national regulations.

The debate on whether an SOE is qualified as 'investors' is essentially a reflection of the current changing landscape of international investment law. As noted in Chapter 1, SOEs as a relatively new actor in international investments were not considered to be a problem when Western countries designed the BITs and investor-state

arbitrations for protecting their private investors and investments against host states' adverse conduct. Given that most SOEs are from emerging economies such as China, Western countries may have to face a dilemma where SOEs can challenge their regulatory measures at international tribunals, and their domestic policies are likely to be subject to closer scrutiny by tribunals. As a result, some Western countries are reluctant to admit SOEs as qualified investors and have attempted to exclude SOEs from investor-state arbitrations. Meanwhile, concerns may also arise that given SOEs - or even state - can file a case against another state, the investment arbitration may spoil the 'equality of arms' in the investor-state arbitration procedures as the SOE investors are not as weak as private investors but are privileged in and backed by their home government. If so, it seems necessary to reconsider the rights and obligations between the SOE and the state to strike a proper balance. I will return to these discussions in Chapter 6.

As a conclusion of this chapter, it is pressing for policymakers to review the international investment regime, especially updating the old generation treaties to deal with challenges by SOEs. Hence, states are advised to rethink and carefully redefine the key terms in relation to SOEs to achieve further clarity and ensure they reflect the common intent of the treaty parties in this respect. Additionally, if states have allowed sovereign investors to pursue international investment arbitration, they may need to further consider whether there is a call for any adjustment of substantive treaty protections, because SOEs are likely to challenge host states' restrictive measures in breach of international obligations such as NDT and FET. The following chapters will discuss whether or not it is necessary to further clarify relevant substantive provisions under investment treaties in order to strike a proper balance between the protection and the regulation of SOE investments.

## CHAPTER 3:

### ADMISSION OF FOREIGN SOES

#### 3.1 Introduction

This chapter deals with the issue of admission of foreign SOEs. While states may need foreign SOE capital for economic development and prosperity, they have also a perceived need to control the admission of foreign SOEs to protect important national interests.<sup>1</sup> As noted, an increasing number of states have adopted various approaches, *inter alia*, tightened investment screening, to control admission of foreign SOEs, especially in critical infrastructure or strategic industries.<sup>2</sup> Many cases and debates arise accordingly. In the context of international investment law, host states still retain considerable discretion to control the admission of foreign SOEs. In most treaties concluded by European countries, the admission clause indicates that the host state can unilaterally decide upon the admission of foreign investors in accordance with its legislation.<sup>3</sup> However, the US, followed by Canada, Japan and some other countries, has extended the non-discriminatory treatment of foreign investors to pre-establishment phase.<sup>4</sup> In such a case, a host state discretion to control the admission of foreign SOEs is subject to its international commitments to market access, including pre-establishment non-discriminatory treatment, where an SOE investor may challenge domestic regulatory measures on the admission in international investment arbitration.

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<sup>1</sup> Jeswald W Salacuse, *The Law of Investment Treaties* (Second Edi, OUP 2015) 217.

<sup>2</sup> *ibid*; UNCTAD, *World Investment Report 2016 - Investment Nationality: Policy Challenges* (UN Publication 2016) xxxi. ('... [S]tate ownership is seen as an increased risk for a transaction being undertaken for other than purely economic motives. This is especially the case if the acquisitions relate to energy, infrastructure services or other industries with 'security dimension'). See also Ch 1.

<sup>3</sup> For example, Article 2 (1) of the Germany-Antigua and Barbuda BIT (1998) provides that, '[e]ach Contracting State shall in its territory promote as far as possible investments by investors of the other Contracting State and admit such investments in accordance with its legislation'. Salacuse (n 1) 218–221; Rudolf Dlozer and Christoph Schreuer, *Principles of International Investment Law* (Second Edi, OUP 2012) 89–90.

<sup>4</sup> For instance, Article 3 of the 2012 US Model BIT provides that, '[e]ach Party shall accord to investors of the other Party treatment no less favourable than that it accords, in like circumstances, to its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments in its territory'. For further discussion on non-discriminatory treatment of SOEs see Ch 4.

The admission of foreign SOEs is a significant but tricky issue at both national and international levels. Not surprisingly, host states favour retaining maximum flexibility of policy discretion to control the admission of foreign SOEs, while SOE investors are expecting to be guaranteed more freedom of accessing to foreign markets based on the non-discrimination standard of treatment. However, SOEs play different roles in different economies where varying foreign investment policies may create different admission requirements for foreign SOEs. In this regard, host states are neither willing to provide an unlimited ‘open market’ to foreign SOEs nor willing to close the door to them. As a result, a conflict may arise between expanding investment liberalisation and restricting admission for national interests. In this context, it is crucial for states to balance the need for foreign SOE investments and to protect certain national interests, i.e., to decide whether and to what extent to open markets to foreign SOEs. But, the problem is how to strike the right balance. In any event, states negotiating investment treaties must be aware that commitments on admission will create international obligations that may constrain the policy discretion to regulate foreign SOEs.

This chapter will explore how states regulate the admission of foreign SOEs under both domestic legal framework and international investment treaties. Section two will focus on domestic regulations, especially different mechanisms for FDI screening on national security grounds and other national interest considerations in selected countries, to compare and analyse their applications for SOE transactions. While domestic legislation plays a dominant role in controlling the admission, it does not mean that investment treaties have no effect on the admission of foreign SOEs. Section three will review admission clauses under IIAs to explore whether and to what extent IIAs guarantee the right of foreign SOEs to access the host state market, especially whether or not recent developments of IIAs contribute to expanding the admission of foreign SOEs and promoting investment liberalisation.

### 3.2 Comparative Analysis of Domestic FDI Reviews: Restricting the Admission of Foreign SOEs?

While inbound foreign investments are subject to a wide-ranging regulatory scheme in host states,<sup>5</sup> a special, and perhaps also the most remarkable and problematic domestic legal regime for foreign SOEs on admission is the mechanism for FDI screening, *inter alia*, on national security grounds. For the purpose of this thesis, this section will review relevant rules in five selected economies that are concerned with SOE investments, including the US, Canada, Australia, the EU and China, and discuss their implications for foreign SOEs to enter in these markets.

### 3.2.1 US: CFIUS Review on National Security

The Committee on Foreign Investment in the United States (CFIUS) has the authority to review foreign investments that might ‘have major implications for the United States national interests’.<sup>6</sup> CFIUS was created by President Ford in 1975,<sup>7</sup> in response to US Congressional concerns over the growing investments in American portfolio assets by the Organization of the Petroleum Exporting Countries (OPEC) members as well as the potentially political - rather than economic - motivations driving those investments.<sup>8</sup> However, caused by national security concerns over a proposed purchase of Fairchild Semiconductor by Fujitsu, the Congress made a significant shift for CFIUS in 1988 by passing the Exon-Florio Amendment (also referred to Section 721 of the Defence Production Act).<sup>9</sup> The Exon-Florio

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<sup>5</sup> For an overview of the US regulatory regime for inbound FDI, see e.g., David N Fagan, ‘The US Regulatory and Institutional Framework for FDI’ in Karl P Sauvart (ed), *Investing in the United State: Is the US Ready for FDI from China?* (Edward Elgar Publishing 2009). For Chinese and US regulatory rules, see also US Chamber of Commerce, ‘China’s Approval Process for Inbound Foreign Direct Investment: Impact on Market Access, National Treatment and Transparency’ (2012)

<[https://www.uschamber.com/sites/default/files/documents/files/020021\\_China\\_InboundInvestment\\_Cvr.pdf](https://www.uschamber.com/sites/default/files/documents/files/020021_China_InboundInvestment_Cvr.pdf)> accessed 12 September 2017.

<sup>6</sup> CFIUS is an interagency committee chaired by the Department of the Treasury and comprised of eight other voting members (the Departments of Commerce, Defense, Homeland Security, Justice, State, and Energy; the US Trade Representative; and the White House Office of Science and Technology); two permanent non-voting members (the Director of National Intelligence and the Department of Labor); and several other White House offices that act as observers and, on a case-by-case basis, participate in CFIUS reviews, see Organisation for International Investment, ‘Understanding the CFIUS Process’

<[http://www.ofii.org/sites/default/files/OFII\\_CFIUS\\_Primer.pdf](http://www.ofii.org/sites/default/files/OFII_CFIUS_Primer.pdf)> accessed September 2017. For more information of CFIUS see James K Jackson, ‘The Committee on Foreign Investment in the United States (CFIUS)’ (2017) Congressional Research Service <<https://fas.org/sgp/crs/natsec/RL33388.pdf>> accessed 12 September 2017.

<sup>7</sup> Executive Order 11858, May 7, 1975, 40 FR 20263.

<sup>8</sup> Jackson (n 6) 1.

<sup>9</sup> Pub. L. 100–418, Title V, § 5021, 102 Stat. 1107 (23 August 1988); 50 USC App §2170 (2007). David Sanger,

Amendment, as a part of the Omnibus Trade and Competitive Act of 1988, transformed the CFIUS review from a limited administrative review to a broad legal screening mechanism in the US for foreign investments, and granted the President far-reaching authority to block foreign acquisitions which result in ‘foreign control of persons engaged in interstate commerce’.<sup>10</sup> A few years later, the Byrd Amendment required the Committee to perform investigations in transactions concerning ‘an entity controlled by or acting on behalf of a foreign government’; it also required the President to provide Congress with a written report on the findings and conclusions of the CFIUS investigation.<sup>11</sup> The new CFIUS review architecture was formalised by the Foreign Investment and National Security Act of 2007 (FINSa) in response to the DP World controversy.<sup>12</sup> In 2006, CFIUS and President Bush approved a purchase of major US port operations by the DP World, but the decision was then subject to great congressional and public criticism concerning the potential risk of terrorist attacks in the US.<sup>13</sup> The FINSa codified pre-existing CFIUS practices and established the congressional oversight system.<sup>14</sup> Under the FINSa, CFIUS shall ‘immediately conduct an investigation’ of the effects of certain transactions on US national security and ‘Congress more explicitly identified itself

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‘Japanese Purchase of Chip Maker Canceled after Objection in U.S.’ *The New York Times* (Tokyo, 17 March 1987) <<http://www.nytimes.com/1987/03/17/business/japanese-purchase-of-chip-maker-canceled-after-objections-in-us.html>> accessed 12 September 2017.

<sup>10</sup> Pub. L. 100–418, Title V, § 5021, 102 Stat. 1107 (23 August 1988); 50 USC App §2170 (2007). José Alvarez, ‘Political Protectionism and United States International Investment Obligations in Conflict: The Hazards of Exon-Florio’ (1990) 30 *Virginia Journal of International Law* 1, 4.

<sup>11</sup> National Defense Authorization Act for Fiscal Year 1993, Pub. L. 102–484, § 837, 106 Stat. 2315 (23 October 1992). David Zaring, ‘CFIUS as a Congressional Notification Service’ (2009) 83 *Southern California Law Review* 81, 94.

<sup>12</sup> Simpson Thacher, ‘Reform of the CFIUS Process In the Wake of Dubai Ports World’ (10 August 2007) <<http://www.stblaw.com/docs/default-source/cold-fusion-existing-content/publications/pub624.pdf?sfvrsn=2>> accessed 12 September 2017; Backer 76.

<sup>13</sup> The American public and many members of Congress criticised DP World for creating a national security risk because of ‘the UAE’s history as an operation and financial base for the hijackers who carried out the 911 attack’, see Thacher (n 12); Deborah M Mostaghel, ‘Dubai Ports World Under Exon-Florio: A Threat to National Security or a Tempest in a Seaport?’ (2007) 70 *Albany Law Review* 583, 606.

<sup>14</sup> Alan P Larson and others, ‘Lessons From CFIUS for National Security Reviews of Foreign Investment’ in Karl P Sauvart, Lisa E Sachs and Wouter PF Schmit Jongbloed (eds), *Sovereign Investment: Concerns and Policy Reactions* (OUP 2012) 422; Paul Rose, ‘Foreign Investment and National Security Act of 2007: An Assessment of Its Impact on Sovereign Wealth Funds and State-Owned Enterprises’ in Fabio Bassan (ed), *Research Handbook on SWFs and International Investment Law* (EE Publishing 2015) 166.



as the monitor of the Committee’ where CFIUS must ‘promptly provide briefings’ upon request by Congress.<sup>15</sup>

All ‘covered’ foreign investment transactions, including any merger, acquisition or takeovers that might result in ‘foreign control of any person engaged in interstate commerce in the US’,<sup>16</sup> are subject to the CFIUS review.<sup>17</sup> Here, the term ‘covered transactions’ is broad to cover foreign government-controlled transactions.<sup>18</sup> The process (Figure 3.1) begins either by parties to a proposed or completed transaction submitting a voluntary notice, or by the President or any member of CFIUS initiating a review.<sup>19</sup> The Treasury Department Regulations indicated that it would clearly be appropriate to notify CFIUS when the acquisition was involved with ‘products or key technologies essential to US defence’.<sup>20</sup> After receiving formal notification, CFIUS would have 30 days to review the transaction to ‘determine the effects of the transaction on the national security of the United States’.<sup>21</sup> Under the following conditions, CFIUS is required to conduct a 45-day investigation and take any necessary actions: (1) CFIUS determines that the transactions threaten to impair the national security of the US and that the threat had not been mitigated during or prior to a review of the transaction; (2) the foreign person is controlled by a foreign government; or (3) the transactions would result in the control of any critical infrastructure by a foreign person and could impair national security, and that such impairment had not been mitigated.<sup>22</sup> Regardless of the CFIUS decision in investigation, the President would have almost unlimited authority to take action to ‘suspend or prohibit any covered transaction that threatens to impair the national

<sup>15</sup> Pub. L. 110-49, 121 Stat. 248 [50 USC App. 2170], (b) (2); 121 Stat. 256 [50 USC App. 2170(g)], (g) (1). Zaring (n 11).

<sup>16</sup> 31 CFR Ch VIII (7-1-09 Edition), § 800.224 (2008).

<sup>17</sup> For essential elements of the ‘covered transactions’ see 31 CFR Ch VIII (7-1-09 Edition), § 800.226 (2008).

<sup>18</sup> A ‘foreign government-controlled transaction’ is a covered transaction that ‘could result in the control of a US business by a foreign government or a person controlled by or acting on behalf of a foreign government’, see 31 CFR Ch VIII (7-1-09 Edition), § 800.214 (2008).

<sup>19</sup> Pub. L. 110-49, 121 Stat. 247 [50 USC App. 2170] (26 July 2007), (b) (1) (C) & (D). Jackson (n 6) 13.

<sup>20</sup> 31 CFR Ch VIII, Pt. 800, App. A - Preamble to Regulations on Mergers, Acquisitions, and Takeovers by Foreign Persons (21 November 1991) <<https://www.gpo.gov/fdsys/pkg/CFR-2007-title31-vol3/xml/CFR-2007-title31-vol3-part800.xml#seqnum800.702>> accessed 12 September 2016.

<sup>21</sup> Pub. L. 110-49, 121 Stat. 247 [50 USC App § 2170] (26 July 2007), (b) (1) (A).

<sup>22</sup> *ibid*, (b) (2) (A). See also Jackson (n 6) 13.

security of the United States’.<sup>23</sup> In any event, the President must announce his decision ‘not later than 15 days’ after the completion of the investigation.<sup>24</sup> Importantly, the President’s determinations are not subject to judicial review.<sup>25</sup>

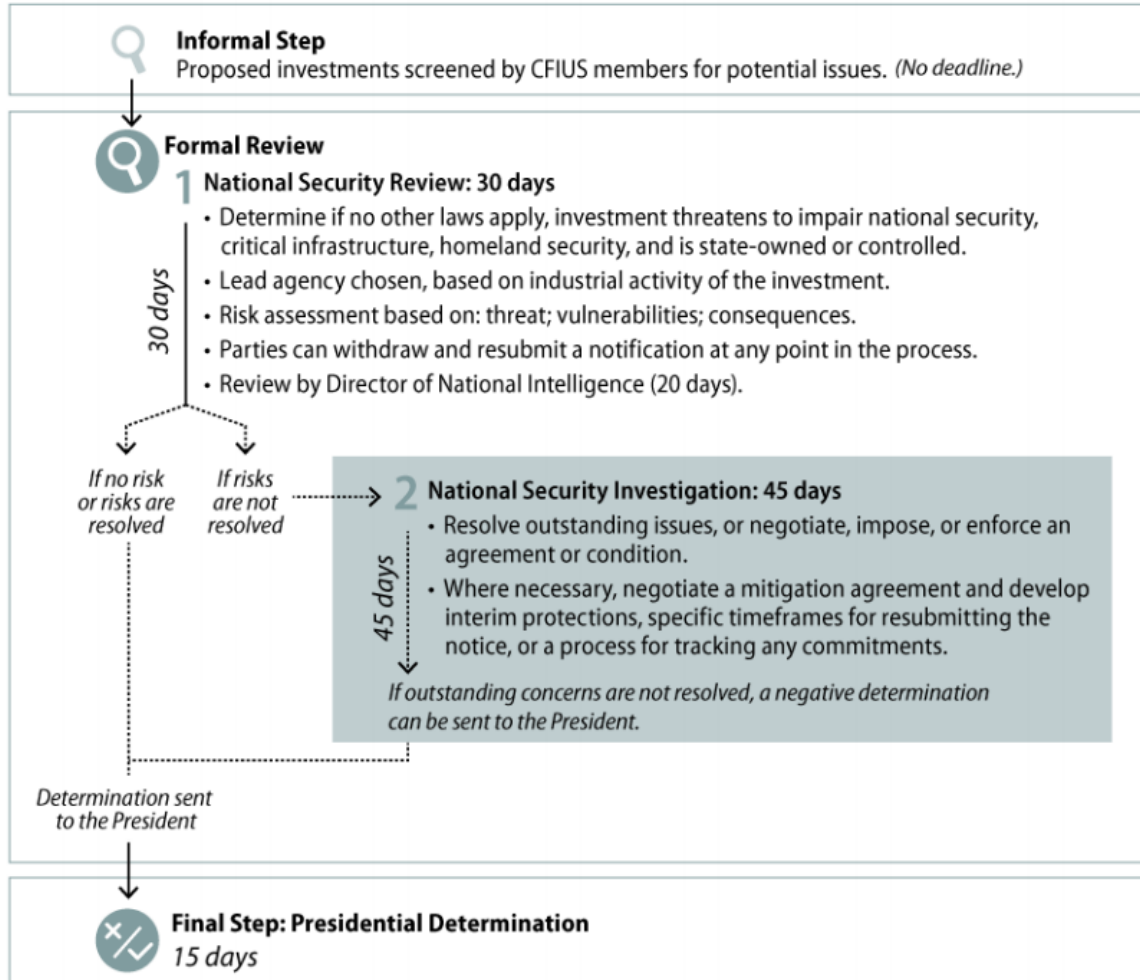


Figure 3.1 Steps of a CFIUS foreign investment national security review

Source: Jackson JK, ‘The Committee on Foreign Investment in the United States (CFIUS)’ (2017) 11 <<https://fas.org/sgp/crs/natsec/RL33388.pdf>>.

According to the legislation, foreign SOE transactions may be subject to greater scrutiny by CFIUS. First, any foreign government-controlled transaction is subject to

<sup>23</sup> Congress directed that the President must consider two conditions before blocking or pending foreign transaction, namely, that other laws are inadequate or inappropriate, and that he has ‘credible evidence’ that a foreign transaction will impair national security; but, these conditions are very vague and limited. Pub. L. 110-49, 121 Stat. 255 [50 USC App § 2170] (26 July 2007), (d) (1); Jackson (n 6) 14.

<sup>24</sup> *ibid.*, (d) (2).

<sup>25</sup> This is also addressed in the *Ralls Corporation v. Committee on Foreign Investment in the United States*, 758 F3d 296, 325 (DC Cir 2014). See Jackson (n 6) 27.

a 45-day investigation.<sup>26</sup> Although the FINSA provides that an investigation can be exempted if the Secretary of the Treasury and the head of the lead agency jointly determine that the transaction in question will not impair the national security, such an exception is somewhat unclear and inapplicable in most cases.<sup>27</sup> Meanwhile, whether or not the covered transaction is controlled by a foreign government is a factor that CFIUS has to consider for national security in the 30-day review.<sup>28</sup> Hence, most (if not all) of the foreign SOE transactions are subject to a full CFIUS investigation.

More importantly, the term ‘foreign government-controlled’ is broadly defined to include not only control (of a US business) by ‘a foreign government’, but also control by ‘a person [that] is controlled by or acting on behalf of a foreign government’.<sup>29</sup> In this context, any foreign transactions resulting in the control of US businesses by, among others, foreign government agencies, SOEs, government pension funds, SWFs, or even private enterprises influenced or favoured by a foreign government, are likely subject to a full CFIUS review. For example, in the Huawei - 3Leaf case, US officials were concerned that Huawei, a private company, might be a state-favored enterprise due to its close ties to the Party and the Chinese government. In this sense, any powerful private company could potentially be a state-favored company subject to a full CFIUS review.<sup>30</sup> Moreover, the key term ‘control’ to covered transactions is also broadly defined to include both majority and dominant minority interests in any entity.<sup>31</sup> Also, ‘ten percent or less of the outstanding voting interest in a US business’ also constitutes ‘control’ of the transaction, unless it is

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<sup>26</sup> Jackson (n 6), 14.

<sup>27</sup> Pub. L. 110-49, 121 Stat. 249 [50 USC App § 2170], (26 July 2007), (b) (2) (D). Some argue that it is unclear how this exception will mesh with the established process, see James K Jackson, ‘The Committee on Foreign Investment in the United States (CFIUS)’ (2016) 20 <<http://www.fas.org/sgp/crs/natsec/RL33388.pdf>> accessed 12 September 2017.

<sup>28</sup> Pub. L. 110-49, 121 Stat. 253, §721 (f), [50 USC App § 2170(f)] (26 July 2007).

<sup>29</sup> 31 CFR § 800.214.

<sup>30</sup> Daniel CK Chow, ‘Why China Wants A Bilateral Investment Treaty with the United States’ (2015) 33 Boston University International Law Journal 101, 116.

<sup>31</sup> The term ‘control’ means the power, direct or indirect, whether or not exercised, through the ownership of a majority or a dominant minority of the total outstanding voting interest in an entity, board representation, proxy voting, a special share, contractual arrangements, formal or informal arrangements to act in concert, or other means, to determine, direct, or decide important matters affecting an entity; in particular, but without limitation, to determine, direct, take, reach, or cause decisions regarding the following matters, or any other similarly important matters affecting an entity, 31 CFR § 800.204 (a).

‘solely for the purpose of passive investment’.<sup>32</sup> Thus, the standard of ‘control’ required by CFIUS is very low, and foreign SOEs must be aware that even relatively small ownership of the US firm could be subject to a full CFIUS investigation.<sup>33</sup>

Second, while there is no precise definition of national security,<sup>34</sup> the CFIUS statute includes an open-ended list of factors that the President and CFIUS members must consider in determining if a particular transaction threatens to impair national security.<sup>35</sup> Factors for consideration include:

- (1) domestic production needed for projected national defense requirements;
- (2) capability and capacity of domestic industries to meet national defense requirements, including the availability of human resources, products, technology, materials, and other supplies and services;
- (3) control of domestic industries and commercial activity by foreign citizens as it affects the capability and capacity of the US to meet the requirements of national security;
- (4) potential effects of the transactions on the sales of military goods, equipment, or technology to a country that supports terrorism or proliferates missile technology or chemical and biological weapons; and transactions identified by the Secretary of Defense as ‘posing a regional military threat’ to the interests of the United States;
- (5) potential effects of the transaction on U.S. technological leadership in areas affecting U.S. national security;
- (6) whether the transaction has a security-related impact on critical infrastructure in the United States;
- (7) potential effects on United States critical infrastructure, including major energy assets;
- (8) potential effects on United States critical technologies;
- (9) whether the transaction is a foreign government-controlled transaction;
- (10) in cases involving a government-controlled transaction, a review of (A) the adherence of the foreign country to nonproliferation control regimes, (B)

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<sup>32</sup> 31 CFR § 800.302(b), § 800.223.

<sup>33</sup> Rose (n 14) 159.

<sup>34</sup> Notably, the amended Sec 721 clarified that ‘[t]he term “national security” shall be construed so as to include those issues relating to ‘homeland security’, including its application to critical infrastructure’, Pub. L. 110-49, 121 Stat. 247 [50 USC App § 2170] (26 July 2007), (a) (5).

<sup>35</sup> Pub. L. 110-49, 121 Stat. 253, § 721 (f) [50 USC App § 2170(f)] (26 July 2007). See also Section 721 of the Defense Production Act of 1950, as amended, 7-8 <<https://www.treasury.gov/resource-center/international/foreign-investment/Documents/Section-721-Amend.pdf>> accessed 12 September 2017.

the foreign country's record on cooperating in counter-terrorism efforts, (C) the potential for transshipment or diversion of technologies with military applications;

(11) long-term projection of the United States requirements for sources of energy and other critical resources and materials; and

(12) such other factors as the President or the Committee determine to be appropriate.<sup>36</sup>

According to the list, if a transaction is controlled by a foreign government, it is strongly presumed to threaten or impair US national security. In reviewing foreign government-controlled transactions, CFIUS considers all relevant facts and circumstances, among others:

- the extent to which the basic investment management policies of the investor require investment decisions to be based solely on commercial grounds;
- the degree to which, in practice, the investor's management and investment decisions are exercised independently from the controlling government, including whether governance structures are in place to ensure independence;
- the degree of transparency and disclosure of the purpose, investment objectives, institutional arrangements, and financial information of the investor; and
- the degree to which the investor complies with applicable regulatory and disclosure requirements of the countries in which they invest.<sup>37</sup>

Although the government stated that 'the fact that a transaction is foreign government-controlled does not, in itself, mean that it poses a national security risk',<sup>38</sup> CFIUS may in practice conduct closer scrutiny of foreign government-controlled transactions considering the above additional facts and circumstances.

Moreover, the concept of 'national security' was defined to include various issues relating to 'homeland security', including its application to critical infrastructure.<sup>39</sup>

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<sup>36</sup> *ibid.* See also Jackson (n 6) 18.

<sup>37</sup> Guidance Concerning the National Security Review Conducted by CFIUS, 73 Fed. Reg. 74567 (8 December 2008).

<sup>38</sup> *ibid.*

<sup>39</sup> The Defense Production Act of 1950, Pub. L. 111-67, § 721 [50 USC App § 2170] (30 September 2009), (a) (5).

Furthermore, ‘critical infrastructure’ is defined broadly as ‘any systems and assets, whether physical or virtual, so vital to the United States that the degradation or destruction of such systems and assets would have a debilitating impact on national security, including, but not limited to, national economic security and national public health or safety’.<sup>40</sup> As stipulated in section 721 and other regulations, CFIUS determines whether or not a transaction involves critical infrastructure on a case-by-case basis, depending on the importance of the particular assets involved in the transaction.<sup>41</sup> Some sectors are likely candidates for consideration as components of the national critical infrastructure,<sup>42</sup> including telecommunications, energy, financial services, water, transportation sectors,<sup>43</sup> and the ‘cyber and physical infrastructure services critical to maintaining the national defence, continuity of government, economic prosperity, and quality of life in the United States’.<sup>44</sup> In 2013, the Department of Homeland Security identified 16 sectors as critical to the US infrastructure through a Presidential Policy Directive to strengthen the security and resilience its critical infrastructure against both physical and cyber threats.<sup>45</sup>

Jackson argues that the additional factors for national security consideration added through the FINSA, *inter alia*, the effects on critical infrastructure or critical technologies, actually ‘incorporate economic considerations into the CFIUS review process’ in a way that was specifically rejected by the previously legislations, and refocus CFIUS’s reviews and investigations on considering ‘the broader rubric of economic security’.<sup>46</sup> In this context, CFIUS review of foreign SOE transactions will be very uncertain and unpredictable, considering that foreign SOE transactions have

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<sup>40</sup> *ibid* (2).

<sup>41</sup> Guidance Concerning the National Security Review Conducted by CFIUS, 73 Fed. Reg. 74567 (8 December 2008).

<sup>42</sup> Jackson (n 6) 16.

<sup>43</sup> 42 USC §5195c (b) (2).

<sup>44</sup> 42 USC §5195c (b) (3).

<sup>45</sup> Sectors include: (1) chemical; (2) commercial facilities; (3) communications; (4) critical manufacturing; (5) dams; (6) defense industrial base; (7) emergency services; (8) energy; (9) financial services; (10) food and agriculture; (11) government facilities; (12) healthcare and public health; (13) information technology; (14) nuclear reactors, materials, and waste; (15) transportation systems; (16) water and wastewater systems. See ‘Presidential Policy Directive - Critical Infrastructure Security and Resilience’ *The White House Office of the Press Secretary* (12 February 2013) <<https://obamawhitehouse.archives.gov/the-press-office/2013/02/12/presidential-policy-directive-critical-infrastructure-security-and-resil>> accessed 12 September 2017.

<sup>46</sup> Jackson (n 6) 19.

raised both economic and national security concerns. For example, some arguably consider that activities of foreign SOEs are not motivated primarily by competitive commercial gains, but at acquiring information concerning the national security interests of a foreign government. Thus, CFIUS may face challenges in determining the potential threat that any single SOE transaction might hold for the US economy or US national security.<sup>47</sup> Also, the DP World transaction sparked a wide-ranging discussion over the economic impact of foreign investments which suggested a problematic issue of the national economic security implications of foreign SOE investments.<sup>48</sup> Although there is little economic evidence to date to conclude that a foreign SOE investment has a measurable impact on the US economy,<sup>49</sup> it is still unclear and disputable whether the potential economic distortions by foreign SOE investments will pose a threat to national security or homeland security.

Notably, CFIUS determinations on national security implications of foreign SOE transactions might be politicised by the scrutiny of the President and the Congress. For example, even if the Committee decides there is no national security risk, the President has almost unlimited authority to take ‘such action for such time as the President considers appropriate to suspend or prohibit any covered transaction that threatens to impair the national security of the United States’.<sup>50</sup> As noted by the Department of the Treasury, national security is to be ‘interpreted broadly and without limitation to particular industries’. Ultimately, whether or not a transaction threatens national security ‘rests within the President’s discretion’.<sup>51</sup> In this regard, the unlimited discretion of the President increases the uncertainty and unpredictability of CFIUS reviews for foreign SOEs considering that the President is free at will to delay or block a foreign SOE transaction.

In *Ralls v. CFIUS*, a Chinese company, Ralls, filed a case with the US District Court challenging President Obama’s decision to block its transaction on national security grounds, including an alleged deprivation of Rall’s property interests in violation of

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<sup>47</sup> *ibid* 37.

<sup>48</sup> *ibid* 2; Jackson (n 27) 32.

<sup>49</sup> Jackson (n 6) 39.

<sup>50</sup> *ibid* 28.

<sup>51</sup> 31 CFR Ch VIII (7–1–07 Edition), Pt. 800, App. A, 1088.

the due process clause of the Fifth Amendment of the US Constitution.<sup>52</sup> The District Court dismissed Ralls' due process claim on the ground that Ralls had no property interest protected by the US Constitution.<sup>53</sup> Ralls appealed the decision in the Appeals Court of the District of Columbia in 2014. Although under Section 721 the President's decisions 'shall not be subject to judicial review', the Appeals Court firstly addressed that 'a statutory bar to judicial review precludes review of constitutional claims only if there is 'clear and convincing' evidence that Congress so intended'.<sup>54</sup> According to the Appeals Court, the statutory bar was to preclude the review of a President's decision on suspending or prohibiting a transaction, rather than a review of a constitutional claim 'challenging the process preceding such Presidential action'.<sup>55</sup> Secondly, the Appeals Court found that Ralls did not waive its protected property interests, although it failed to submit a voluntary notice 'before the transaction [was] completed'.<sup>56</sup> Thirdly, the Court held that, 'due process requires... that an affected party is informed of the official action, be given access to the unclassified evidence on which the official actor relied and be afforded an opportunity to rebut that evidence', but Rall was not given any of these procedural protections at any point.<sup>57</sup> Accordingly, the Court concluded that 'the Presidential Order deprived Ralls of constitutionally protected property interests without due process of law'.<sup>58</sup> The case has attracted a strong international reaction as a 'landmark judgement' to lead to 'big changes' in how the US conducts national security reviews of foreign investments.<sup>59</sup> However, as noted by scholars, providing acquirers with an opportunity to review and rebut evidence does not suggest in any way that there will be corresponding changes in the outcomes of CFIUS reviews.<sup>60</sup>

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<sup>52</sup> *Ralls v. CFIUS*, 758 F3d 296, 325 (DC Cir 2014). See also Jackson (n 6) 27-9.

<sup>53</sup> *ibid* 307.

<sup>54</sup> *ibid* 308.

<sup>55</sup> *ibid* 311.

<sup>56</sup> *ibid* 316-7.

<sup>57</sup> *ibid* 320.

<sup>58</sup> *ibid* 325.

<sup>59</sup> See e.g., Frank Ching, 'US court overrules investment ban' *The China Post* (6 August 2014) <<http://www.chinapost.com.tw/commentary/china-post/frank-ching/2014/08/06/414119/us-court.htm>> accessed 12 September 2017; William Mauldin and Brent Kendall, 'Appeals Court Faults Government Order Prohibiting Ralls Corp. Wind Farm Deal' *The Wall Street Journal* (15 July 2014) <<https://www.wsj.com/articles/appeals-court-faults-government-order-prohibiting-ralls-corp-wind-farm-deal-1405439077>> accessed 12 September 2017.

<sup>60</sup> Mark Feldman, 'China's Outbound Foreign Direct Investment: The US Experience' (2017) 13 *International Journal of Public Policy* 304, 316.



Moreover, the FINSA established a congressional oversight system where CFIUS is required to brief certain congressional leaders upon request and to report annually to Congress on any reviews or investigations.<sup>61</sup> Feldman argues that US Congress in fact have played a central role in a few transactions by Chinese acquirers and members of the Congress can - and indeed have - considered factors beyond the scope of national security when evaluating proposed foreign transactions.<sup>62</sup> As a result, political controversy may develop between the Congress and CFIUS. The DP World transaction revealed a different viewpoint of some members of Congress regarding the role of foreign investment in the economy and the impact on national security, which resulted in the amendment of the CFIUS process.<sup>63</sup> In this regard, it is possible for CFIUS to strengthen the scrutiny of foreign SOE transactions further, especially considering that the US-China Economic and Security Review Commission, a congressional panel, recently urged to ban all Chinese SOE transactions.<sup>64</sup>

### 3.2.2 Canada: Security Review in addition to ‘Net Benefit’ Test

Foreign investments in Canada are subject to the Investment Canada Act (ICA) which requires a review of significant investments in Canada by non-Canadians (‘net benefit’ review). It also includes investments in Canada by non-Canadians that could be injurious to national security (national security review).<sup>65</sup> A net benefit review occurs when acquisitions of control of a Canadian business exceed certain prescribed financial thresholds. An acquisition by a non-Canadian of one-third or more of the voting rights of a Canadian business is presumed to be an acquisition of control unless there is proof that the acquired shares do not give the investor ‘control-in-fact’.<sup>66</sup> The review threshold for private investors in 2015 was C\$600 million in enterprise value of assets while that for SOE investors was C\$375 million in book

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<sup>61</sup> Jackson (n 6) 20.

<sup>62</sup> Feldman (n 60) 310.

<sup>63</sup> Jackson (n 6) 8.

<sup>64</sup> See also US - China Economic and Security Review Commission, ‘2016 Annual Report To Congress’ (2016) <[https://www.uscc.gov/Annual\\_Reports/2016-annual-report-congress](https://www.uscc.gov/Annual_Reports/2016-annual-report-congress)> accessed 12 September 2017. For more discussion see Sec. 3.2.6.

<sup>65</sup> Investment Canada Act, RSC, 1985, c 28 (1st Supp.), s 2; 2009, c 2, s 445. The national security review was added in 2009 amendments.

<sup>66</sup> RSC, 1985, c 28 (1st Supp.), s 28; 1993, c 35, s 5; 1995, c 1, s 50; 2009, c 2, s 455; 2013, c 33, s 144.

value of assets.<sup>67</sup> Acquisitions that do not exceed relevant thresholds or investments to establish new Canadian businesses (other than cultural businesses) are merely subject to notification.<sup>68</sup> The reviewable investments will be assessed by relevant factors till the Minister is satisfied that the investment is likely to be of ‘net benefit’ to Canada.<sup>69</sup>

During the past decade, the Canadian government has strengthened regulations for acquisitions by foreign SOEs through ICA amendments. First, the definition of SOE has been expanded to cover a broad range of government-related entities, including foreign governments acting as investors in their own right as well as individuals acting on behalf of a government.<sup>70</sup> Second, the review threshold for SOE investments is much lower than that for private sectors.<sup>71</sup> Moreover, the Minister may determine that a Canadian business is controlled *in fact* by the acquisition of a foreign SOE even where the one-third or more threshold is not met.<sup>72</sup> Third, when assessing whether acquisitions by foreign SOEs are of net benefit to Canada, the

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<sup>67</sup> Notably, the review thresholds here are for direct acquisitions except of cultural businesses, and the threshold of \$C600 million is only for WTO investors. For non-WTO investor, the threshold is C\$5 million of a direct acquisition and C\$50 million of an indirect acquisition.

<sup>68</sup> RSC, 1985, c. 28 (1st Supp.), s 12; 1995, c 1, s 50.

<sup>69</sup> The factors for ‘net benefit’ consideration include:

- (a) the effect of the investment on the level and nature of economic activity in Canada, including, without limiting the generality of the foregoing, the effect on employment, on resource processing, on the utilization of parts, components and services produced in Canada and on exports from Canada;
- (b) the degree and significance of participation by Canadians in the Canadian business or new Canadian business and in any industry or industries in Canada of which the Canadian business or new Canadian business forms or would form a part;
- (c) the effect of the investment on productivity, industrial efficiency, technological development, product innovation and product variety in Canada;
- (d) the effect of the investment on competition within any industry or industries in Canada;
- (e) the compatibility of the investment with national industrial, economic and cultural policies, taking into consideration industrial, economic and cultural policy objectives enunciated by the government or legislature of any province likely to be significantly affected by the investment; and
- (f) the contribution of the investment to Canada’s ability to compete in world markets.

RSC, 1985, c 28 (1st Supp.), s 21; 1995, c 1, s 50; 2009, c 2, s 452; 2013, c 33, s 138; 2014, c 39, s 188.

<sup>70</sup> 2009, c 2, s 446. Previously, the SOE Guideline provides that ‘an SOE is an enterprise that is owned, controlled or influenced, directly or indirectly by a foreign government’, see <[www.ic.gc.ca/eic/site/ica-lic.nsf/eng/lk00064.html#p2](http://www.ic.gc.ca/eic/site/ica-lic.nsf/eng/lk00064.html#p2)> accessed 5 March 2017.

<sup>71</sup> To be specific, the review threshold for private sector investments is \$1 billion while that for SOE investments is \$379 million, see <[https://www.ic.gc.ca/eic/site/ica-lic.nsf/eng/h\\_lk00050.html](https://www.ic.gc.ca/eic/site/ica-lic.nsf/eng/h_lk00050.html)> accessed 28 August 2017.

<sup>72</sup> 2009, c 2, s 455(4).

Minister shall focus on the ‘governance’ and ‘commercial orientation’ of the SOEs.<sup>73</sup>

To be specific, the Minister will examine:

- (1) the corporate governance and reporting structure of the foreign SOE, including whether the SOE adheres to Canadian standards of corporate governance (including, for example, commitments to transparency and disclosure, independent members of the board of directors, independent audit committees and equitable treatment of shareholders), and to Canadian laws and practices, including adherence to free market principles;
- (2) the effect of the SOE investment on the level and nature of economic activity in Canada, including the effect on employment, production and capital levels in Canada; how and the extent to which the foreign SOE is owned, controlled by a state or its conduct and operations are influenced by a state;
- (3) whether the Canadian business to be acquired by foreign SOE will likely operate on a commercial basis, including where to export; where to process; the participation of Canadians in its operations in Canada and elsewhere; the impact of the investment on productivity and industrial efficiency in Canada; support of on-going innovation, research and development in Canada; and the appropriate level of capital expenditures to maintain the Canadian business in a globally competitive position.<sup>74</sup>

According to the legislation, the burden of proof of net benefit is on foreign SOEs who are expected to address in their plans and undertakings the inherent characteristics of SOEs (specifically that they are susceptible to state influence) and to demonstrate their strong commitment to transparent and commercial operations.<sup>75</sup> Furthermore, foreign SOEs are encouraged to submit specific undertakings relating to certain aspects of the business, including the appointment of Canadians as independent directors on the board of directors; the employment of Canadians in senior management positions; the incorporation of the business in Canada; and the listing of shares of the acquiring company or the Canadian business being acquired

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<sup>73</sup> Innovation, Science and Economic Development Canada, ‘Guidelines - Investment by state-owned enterprises - Net benefit assessment’ (Modified on 19 Dec 2016) <<http://www.ic.gc.ca/eic/site/ica-lic.nsf/eng/lk00064.html#p2>> accessed 6 March 2017.

<sup>74</sup> *ibid.*

<sup>75</sup> *ibid.*

on a Canadian stock exchange.<sup>76</sup> Recent transactions show that foreign SOEs have made commitments mirroring the examples in the SOE Guidelines.<sup>77</sup> In 2012, the government clarified that free enterprise principles and industrial efficiency are considered in reviews of foreign SOE acquisitions, and it will find the acquisition of control of a Canadian oil sands business by a foreign SOE to be of net benefit to Canada on ‘an exceptional basis’ only.<sup>78</sup>

In 2009, the amended ICA introduced a separate process of national security review that allows the Minister and the Governor in Council to review the foreign investment if there are ‘reasonable grounds to believe that investment by a non-Canadian could be injurious to national security’.<sup>79</sup> However, the term ‘national security’ was not defined, and little practical guidance was provided to foreign investors until the government issued Guidelines on the National Security Review of Investments in December 2016.<sup>80</sup> In particular, the Guidelines provided a non-exhaustive list of factors for national security consideration by the Minister or Governor in Council, including but not limited to:

- 1) The potential effects of the investment on Canada's defence capabilities and interests;
- 2) The potential effects of the investment on the transfer of sensitive technology or know-how outside of Canada;
- 3) Involvement in the research, manufacture or sale of goods/technology identified in Section 35 of the Defence Production Act;
- 4) The potential impact of the investment on the security of Canada's critical infrastructure. Critical infrastructure refers to processes, systems, facilities, technologies, networks, assets and services essential to the health, safety,

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<sup>76</sup> *ibid.*

<sup>77</sup> For example, CNOOC's acquisition of Nexen in 2012, Du, ‘The Regulation of Chinese State-Owned Enterprises in National Foreign Investment Laws: A Comparative Analysis’ 129.

<sup>78</sup> Innovation, Science and Economic Development Canada, ‘Statement Regarding Investment by Foreign State-Owned Enterprises’ (Modified on 7 Dec 2012) <<http://www.ic.gc.ca/eic/site/ica-lic.nsf/eng/lk81147.html>> accessed 6 March 2017.

<sup>79</sup> 2009, c 2, s 453; 2013, c 33, s 140.

<sup>80</sup> Innovation, Science and Economic Development Canada, ‘Guidelines on the National Security Review of Investments’ (Modified on 19 Dec 2016) <<https://www.ic.gc.ca/eic/site/ica-lic.nsf/eng/lk81190.html>> accessed 6 March 2017.

security or economic well-being of Canadians and the effective functioning of government;<sup>81</sup>

- 5) The potential impact of the investment on the supply of critical goods and services to Canadians, or the supply of goods and services to the Government of Canada;
- 6) The potential of the investment to enable foreign surveillance or espionage;
- 7) The potential of the investment to hinder current or future intelligence or law enforcement operations;
- 8) The potential impact of the investment on Canada's international interests, including foreign relationships; and,
- 9) The potential of the investment to involve or facilitate the activities of illicit actors, such as terrorists, terrorist organisations or organised crime.<sup>82</sup>

Also, the Governor in Council has the authority to take any measures against foreign investment for national security reasons, including permitting the investment to proceed with or without conditions or prohibiting the investment or, if already made, requiring the divestiture of the investment.<sup>83</sup> Since 2009, some proposed and implemented investments have raised national security issues, but very few were blocked by the federal government on national security concerns.<sup>84</sup> In 2015, it was reported that the Canadian government blocked a Chinese SOE to build fire-alarm systems in Quebec under a national security review because the factory was too close to the headquarters of the Canadian Space Agency.<sup>85</sup> However, some argue that the Canadian government does not presume that an SOE investment, even in the natural resources sectors, will necessarily create national security issues.<sup>86</sup>

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<sup>81</sup> For more information on Canada's critical infrastructure, see Public Safety Canada, 'National Strategy for Critical Infrastructure and Action Plan for Critical Infrastructure' (2009)

<<https://www.publicsafety.gc.ca/cnt/rsrscs/pblctns/srtg-crtcl-nfrstrctr/index-en.aspx>> accessed 6 March 2017.

<sup>82</sup> Innovation, Science and Economic Development Canada, 'Guidelines on the National Security Review of Investments' (Modified on 19 Dec 2016) <<https://www.ic.gc.ca/eic/site/ica-lic.nsf/eng/lk81190.html>> accessed 6 March 2017.

<sup>83</sup> *ibid.* See also Douglas C. New and Grant LoPatriello, 'Investment Canada Issues National Security Review Guidelines' *Lexology* (21 December 2016) <<http://www.lexology.com/library/detail.aspx?g=8c736ba5-e93f-46dc-9d32-765f1e10d9cc>> accessed 6 March 2017.

<sup>84</sup> George N Addy and others, 'Investment Canada Act: Guide for Foreign Investors in Canada' (2016) Davies 35 <<https://www.dwpv.com/en/Insights/Publications/2016/Investment-Canada-Act-Guide-for-Foreign-Investors-in-Canada-2016-Edition?mode=pdf>> accessed 12 September 2017.

<sup>85</sup> Jeff Gray, 'Ottawa's national security review a warning to foreign investors' *The Global and Mail* (July 1, 2015) <<http://www.theglobeandmail.com/report-on-business/industry-news/the-law-page/ottawas-national-security-review-a-warning-to-foreign-investors/article25219593/>> accessed 6 March 2017.

<sup>86</sup> Du (n 77) 130.

Nonetheless, national security review in Canada is more vague and unpredictable in comparison with CFIUS review. To some extent, foreign SOEs are likely to trigger national security concerns, and the review decision might be subjectively affected by political preferences. In 2015, for example, the federal government ordered O-Net, a Chinese developer of optical networking components, to divest of the Canadian firm due to national security concerns.<sup>87</sup> O-Net filed an application for judicial review, and in 2016 the Federal Court ordered to set aside the Cabinet order and conduct a ‘fresh’ review of the investment.<sup>88</sup> The government did not publicly state why it agreed to re-review the transaction, but some noted that the decision was made just after the Prime Minister visited China.<sup>89</sup>

### 3.2.3 Australia: ‘National Interest’ Test

In Australia, the regulatory framework of foreign investments mainly includes the Foreign Acquisitions and Takeovers Act 1975, Foreign Acquisitions and Takeovers Regulation 2015 and Australia’s Foreign Investment Policy. Under the current regime, the Foreign Investment Review Board (FIBR) reviews foreign investment proposals on a case-by-case basis and advises the Treasurer on national interest implications.<sup>90</sup> According to the Policy, all foreign government investors must get approval before acquiring a direct interest in Australia (generally at least 10 per cent, or the ability to influence, participate in or control), starting a new business or acquiring an interest in Australian land, regardless of the value of the investment.<sup>91</sup>

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<sup>87</sup> The reason for government’s concern about national security was not disclosed, but some experts speculated that sales by ITF Technologies Inc., to the Canadian Military might have been a factor, see Carolynne Burkholder-James, ‘O-Net a Bellwether Case for Foreign Investment Review’ *The Canadian Bar Association* (22 Feb 2016) <<https://www.cba.org/Publications-Resources/CBA-Practice-Link/Business-and-Corporate/2016/foreigninvestment>> accessed March 6, 2017.

<sup>88</sup> Sandy Walker (Denton), ‘Back to the drawing board: Canadian Government divestiture order in national security case set aside and new review to take place’ *Lexology* (16 November 2016) <<http://www.lexology.com/library/detail.aspx?g=29a2885d-c4e1-4950-a57a-758ca35a2710>> accessed 6 March 2017.

<sup>89</sup> Steven Chase, ‘Montreal firm targeted in Chinese takeover did research with Canadian government’ *The Globe and Mail* (13 Jan 2017) <<http://www.theglobeandmail.com/news/politics/montreal-firm-targeted-in-chinese-takeover-did-research-with-canadian-government/article33613518/>> accessed 6 March, 2017.

<sup>90</sup> Treasurer, ‘Australia’s Foreign Investment Policy’ (last updated 1 July 2017), 1, <<https://cdn.tspace.gov.au/uploads/sites/82/2017/06/Australias-Foreign-Investment-Policy.pdf>> accessed 28 August 2017.

<sup>91</sup> *ibid* 5.

Moreover, a ‘foreign government investor’ is defined widely as a foreign government or separate government entity, a corporation or trustee of a trust, or a general partner of a limited partnership in which: (1) a foreign government or separate government entity holds a substantial interest of at least 20%; or (2) foreign governments or separate government entities of more than one foreign country (or parts of more than one foreign country) hold an aggregate substantial interest of at least 40%.<sup>92</sup> Accordingly, all major foreign investment involving Chinese SOEs are subject to a national interest review by the FIBR.

As indicated, Australia’s foreign investment review framework attempts to balance the need to welcome foreign investment and the need to protect the national interest. However, the legislation does not define what the national interest is. Instead, it is the Treasurer who has the power to decide in each case whether a particular investment would be contrary to the national interest.<sup>93</sup> When assessing the national interest, the Government will consider a range of factors, typically including (1) national security; (2) competition; (3) other Australian Government policies including tax; (4) impact on the economy and the community; (5) character of the investor.<sup>94</sup>

When the proposed investment involves a foreign government investor, the Government additionally considers whether the investment is commercial in nature or pursuing broader political or strategic objectives in the national interest test. This includes whether or not the prospective investor’s governance arrangements could facilitate actual or potential control by a foreign government including through the investor’s funding arrangements.<sup>95</sup> Proposed SOE investment operating on a fully arm’s length and commercial basis is less likely to raise national interest concerns.<sup>96</sup> The Government does not have a policy of prohibiting SOE investments that are not operating on a fully arm’s length and commercial basis, but it looks at the overall proposal carefully to determine whether such investments are contrary to the national

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<sup>92</sup> *ibid.*, 3.

<sup>93</sup> *ibid.*, 8.

<sup>94</sup> *ibid.*, 8-9.

<sup>95</sup> *ibid.*, 10.

<sup>96</sup> *ibid.*

interest.<sup>97</sup> Mitigating factors that assist in the national interest determination include the existence of external partners or shareholders in the investment; the level of non-associated ownership interests; the governance arrangements for the investment; ongoing arrangements to protect Australian interests from non-commercial dealings; and whether or not the target will be, or remain, listed on the Australian Securities Exchange or another recognised exchange.<sup>98</sup> Also, the Government will consider the size, importance and potential impact of the foreign government investment in considering whether or not the proposal is contrary to the national interest.<sup>99</sup>

### 3.2.4 EU: Member States' Control and EU Regulations

While the freedom of establishment is a fundamental principle in the EU internal market, member states are allowed to scrutinise foreign investments and restrict the access of foreign investors from third countries under the EC Treaty.<sup>100</sup> Moreover, even in the intra-EU, member states can restrict the establishment of foreign investments on the grounds of public security, public policy and public health.<sup>101</sup> Article 346 of the EC Treaty further provides that member states may 'take measures it considered necessary for the protection of the essential interests of its security which are connected with the production of or trade in arms, munitions and war materials'.<sup>102</sup> Also, the EU Merger Regulation provides that member states may take 'appropriate measures' to protect 'legitimate interests' other than competition, including 'public security, plurality of the media and prudential rules'.<sup>103</sup> Traditionally, the EU does not establish a comprehensive review mechanism on national security grounds like the CFIUS but leave member states to scrutinise

<sup>97</sup> *ibid.*

<sup>98</sup> *ibid* 10-11.

<sup>99</sup> *ibid* 11.

<sup>100</sup> Article 49 of TFEU (*ex* Article 43 EC) provides that 'restrictions on the freedom of establishment of nationals of a Member State in the territory of another Member States shall be abolished... Freedom of establishment shall include the right to set up and manage undertakings, under the conditions laid down for its own nationals', Consolidated version of the Treaty on the Functioning of the European Union [2012] OJ C326/47.

<sup>101</sup> Article 52 of TFEU (*ex* Article 46 TEC) provides that, '1. The provisions of this Chapter and measures taken in pursuance thereof shall not prejudice the applicability of provisions laid down by law, regulation or administrative action providing for special treatment for foreign nationals on grounds of public policy, public security or public health', *ibid.*

<sup>102</sup> Article 346 of TFEU (*ex* Article 296 TEC), *ibid.*

<sup>103</sup> Article 21 of the EU Merger Regulation, Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings (the EC Merger Regulation) [2004] OJ L24/1.



foreign investments and restrict the access of foreign investors for public security or other legitimate interests, regardless of public or private ownership.

Germany, for example, introduced a national security screening mechanism in 2004 that required investors from countries other than Member states of the EU and the European Free Trade Association (EFTA) notify the government of the acquisition of any business engaged in manufacturing or developing war weapons or armaments, or producing cryptographic equipment, in cases where the foreign investor directly or indirectly owns 25% or more equity.<sup>104</sup> In 2009, Germany amended its Foreign Investment Act to apply to a transaction by foreign investors of at least 25% voting rights of a German company, regardless of the size and sector, where the Ministry is required to review whether or not the investment threatens public order or public safety.<sup>105</sup> Although the new legislation does not explicitly discriminate between private and public foreign investors, it has been assumed to target foreign sovereign investments given that it was created against non-German SWF investments.<sup>106</sup> The new amendment did not define national security and public order, but it addressed that it would merely apply to ‘a genuine and sufficiently serious threat to one of the fundamental interest of society’.<sup>107</sup> A US Statement considers that the amendment has raised some uncertainties over which transactions should trigger the notification requirement.<sup>108</sup> While some argue that the amended legislation might violate basic freedoms of capital movement and establishment, the Economic Minister Michael Glos insisted that the review process would be applicable in ‘extremely rare’ cases and would not affect ‘the majority of foreign investments’.<sup>109</sup> In 2013, the Capital Investment Code replaced the German Foreign Investment Act, which brought no substantive changes to the notification requirement.<sup>110</sup>

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<sup>104</sup> US Department of State, ‘2016 Investment Climate Statements- Germany’ (2016) <<https://www.state.gov/e/eb/rls/othr/ics/2016/eur/254367.htm>> accessed 12 September 2017.

<sup>105</sup> Thomas Jost, ‘Sovereign Wealth Funds and the German Policy Reaction’ in Karl P Sauvart, Lisa E Sachs and Wouter PF Schmit Jongbloed (eds), *Sovereign Investment: Concerns and Policy Reactions* (OUP 2012) 458, cited sec. 7, para. 2 nr. 6 AWG.

<sup>106</sup> *ibid.*

<sup>107</sup> *ibid.* 459.

<sup>108</sup> US Department of State, ‘2016 Investment Climate Statements- Germany’ (n 104).

<sup>109</sup> Julien Chaisse, ‘The Regulation of Sovereign Wealth Funds in the European Union: Can the Supranational Level Limit the Rise of National Protectionism?’ in Karl P Sauvart, Lisa E Sachs and Wouter PF Schmit Jongbloed (eds), *Sovereign Investment: Concerns and Policy Reactions* (OUP 2012) 493.

<sup>110</sup> US Department of State, ‘2016 Investment Climate Statements- Germany’ (n 104).

In 2005, France issued the Decree 2005-1739, which created an authorisation procedure for foreign investments in certain sectors of activity that could affect public policy, public security or national defence.<sup>111</sup> Although there is no generalised screening of foreign investment, the French law stipulates that acquisitions in sensitive sectors are subject to prior notification, screening and approval by the Finance Minister.<sup>112</sup> Between 2005 and 2015, 17 areas were recognised as sensitive sectors.<sup>113</sup> In such cases any foreign investors that acquire control of more than 33% ownership of a firm, or involve any part of such a company that has established headquarters in France must be subject to review.<sup>114</sup> Also, the review decision is contestable before the administrative law courts.<sup>115</sup>

In the UK, there is no formalised investment review body for foreign investments on national security interests, but an *ad hoc* investment review process does exist and is led by the relevant government ministry with regulatory responsibility for the sectors in question.<sup>116</sup> Moreover, under the Industry Act 1975, the UK Government is entitled to prohibit or restrict a foreign acquisition concerning ‘important manufacturing undertakings’ or on national interest considerations.<sup>117</sup> Also, under the

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<sup>111</sup> European Commission (EC), ‘Free Movement of Capital: Commission Scrutinises French Law Establishing Authorisation Procedure for Foreign Investments in Certain Sectors’ IP/06/438 (Brussels, 4 April 2006) <[http://europa.eu/rapid/press-release\\_IP-06-438\\_en.htm?locale=en](http://europa.eu/rapid/press-release_IP-06-438_en.htm?locale=en)> accessed 12 September 2017.

<sup>112</sup> US Department of State, ‘Investment Climate Statements for 2016- France and Monaco’ (2016) <<https://www.state.gov/e/eb/rls/othr/ics/2016investmentclimatestatements/index.htm?year=2016&dliid=254363#wrapper>> accessed 12 September 2017.

<sup>113</sup> There are eleven strategic sectors, including: gambling; private security services; research, development and production of certain pathogens or toxic substances; wiretapping and communications interception equipment; testing and certification of security for IT products and systems; goods and services related to the information security systems of companies managing critical infrastructure; dual-use (civil and military) items and technologies; encryption services; the activities of firms entrusted with national defense secrets; research, production or trade of weapons, ammunition, and explosive substances intended for military purposes; and any business supplying the Defense Ministry with any of the above goods or services. In May 2014, six new areas were added to the sensitive sectors list, including energy infrastructure; transportation networks; public water supplies; electronic communication networks; public health protection; and installations/works vital to national security. For the legal text see <[http://www.tresor.economie.gouv.fr/4183\\_Textes-de-reference](http://www.tresor.economie.gouv.fr/4183_Textes-de-reference)> accessed 8 July 2017, *ibid*.

<sup>114</sup> *ibid*.

<sup>115</sup> *ibid*.

<sup>116</sup> US Department of State, ‘Investment Climate Statements for 2016- United Kingdom’ (2016) <<http://www.state.gov/e/eb/rls/othr/ics/investmentclimatestatements/index.htm?year=2016&dliid=254431>> accessed 12 September 2017.

<sup>117</sup> The ‘important manufacturing undertaking’ means an undertaking which is wholly or mainly engaged in

Enterprise Act 2002, the Office of Fair Trading (OFT) is obliged to make references to the Competitive Commission (CC) about mergers that might result in a substantial lessening of competition within the UK.<sup>118</sup> But, the Secretary of State of the Department for Business, Innovation and Skills may intervene with OFT and review transactions in certain public interest cases.<sup>119</sup> The interests of national security, including public security in accordance with Article 21 (4) of the EC Merger Regulation, and transactions in the media are specified considerations.<sup>120</sup> In the Enterprise and Regulatory Reform Act 2013, the CC and the OFT merged into the Competition and Markets Authority (CMS) that is now the responsible regulatory body for competition in the UK.<sup>121</sup>

Notably, in September 2017, the European Commission proposed to establish a framework for screening of foreign direct investments into the EU.<sup>122</sup> Whereas the Commission confirmed ‘openness to foreign investment remains a key principle for the EU and a major source of growth’, at the same time it recognised that ‘there have been some concerns about foreign investors, notably state-owned enterprises, taking over European companies with key technologies for strategic reasons’, and that EU investors often do not enjoy the same rights to invest in the country from which the investment originates. The proposed regulation provides legal certainty to ensure EU wide coordination and cooperation by establishing a framework for the screening of FDI in the Union on grounds of security or public order, without prejudiced to the sole responsibility of the member states for maintenance of national security.<sup>123</sup> In screening a foreign investment on the ground of security or public order, member states and the Commission may consider the potential effects on critical infrastructure, critical technologies, the security of supply of critical inputs, or access

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manufacturing industry and appears to the Secretary of State to be of special importance to the UK or to any substantial part of the UK, Industry Act 1975, c 68, s 12, s 13.

<sup>118</sup> Enterprise Act 2002 c. 40, s 22.

<sup>119</sup> Enterprise Act 2002 c. 40, s 42.

<sup>120</sup> Enterprise Act 2002 c. 40, s 58.

<sup>121</sup> Enterprise and Regulatory Reform Act 2013, c 24.

<sup>122</sup> European Commission, ‘Proposal for a Regulation of the European Parliament and of the Council establishing a framework for screening of foreign direct investments into the European Union’ COM(2017) 487 final, 13 September 2017.

<sup>123</sup> *ibid.*, 20. Article 3 provides: 1. Member States may maintain, amend or adopt mechanisms to screen foreign direct investments on the grounds of security or public order, under the conditions and in accordance with the terms set out in this Regulation. 2. The Commission may screen foreign direct investments that are likely to affect projects or programmes of Union interest on the grounds of security or public order.

to sensitive information or the ability to control sensitive information. More importantly, the regulation expressly provides that member states and the Commission may take into account ‘whether the foreign investor is controlled by the government of a third country, including through significant funding’ in determining whether a FDI is likely to affect security or public order.<sup>124</sup>

Accordingly, both member states and the Commission may scrutinise foreign investments and restrict the access of foreign investors for national security or public security, regardless of public or private ownership. Meanwhile, some European countries also maintain a so-called ‘gold share’ policy to restrict foreign participations in privatised companies and strategically sensitive sectors.<sup>125</sup> In France, for example, the 1993 privatisation law allows the government to maintain a golden share, including prior authorisation for acquisitions of more than a certain percentage of a firm’s capital when privatising national companies in order ‘to protect national interests’.<sup>126</sup> Likewise, after the approval of Hinkley new project, the UK government requires a special share in all future nuclear new-build projects. Further, the government will reform the approach to the ownership and control of critical infrastructure to ensure that the full implication of foreign ownership is scrutinised for the purpose of national security.<sup>127</sup>

However, any regulations by member states are subject to EU law, and national restrictions on market access might be challenged as a violation of the EU fundamental freedom of establishment. For example, the European Commission scrutinised the French Decree 2005-1739, i.e., authorisation procedure for foreign investments in certain sectors of activities. Such scrutiny could act as a disincentive to investment from other member states and create a restriction on EU companies,

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<sup>124</sup> *ibid*, Article 4.

<sup>125</sup> Muchlinski PT, *Multinational Enterprises and The Law* (OUP 2007) 189-91. See also Ch 1.

<sup>126</sup> A ‘golden share’ gives the government the right to: require prior authorization from the Ministries of Finance and Economy for any investors acting in concert to own more than a certain percentage of a firm’s capital; name up to two non-voting members to the firm’s board of directors; and block the sale of any asset to protect ‘national interests’, see US Department of State, ‘Investment Climate Statements for 2016- France and Monaco’ (n 112).

<sup>127</sup> Department for Business, Energy & Industrial Strategy, ‘Government confirms Hinkley Point C project following new agreement in principle with EDF’ (15 September 2016)

<<https://www.gov.uk/government/news/government-confirms-hinkley-point-c-project-following-new-agreement-in-principle-with-edf>> accessed 12 September 2017.

directly or indirectly owned by third country investors, in contradiction with EU Treaty rules on the free movement of capital and the right of establishment.<sup>128</sup> In case law, the European Court of Justice (ECJ) has also ruled that golden share measures represent a restriction on the free movement of capital and freedom of establishment.<sup>129</sup> Nonetheless, the practice is not always consistent. For example, the European Commission accepted a 2006 French law that allows the government on energy security grounds to keep a golden share in GDF following its merger with Suez.<sup>130</sup> In some cases, the ECJ has strictly interpreted the derogation of the freedom of establishment on public security or public interest grounds. This includes a requirement of the existence of a genuine and sufficiently serious threat affecting fundamental freedom, and the restrictions should not extend beyond the principle of ‘proportionality’.<sup>131</sup> In *Commission v. Greece*, for instance, the Court found that the prior authorisation scheme for the acquisition of voting rights in certain strategic public limited companies was contrary to EU fundamental freedoms; it considered that the national scheme was applicable without any (not even a potential) risk being created and could not guarantee that all real and serious threats to a legitimate public interest might be identified in advance.<sup>132</sup> But, in *Commission v. Portugal*, the Court agreed with Portugal that the threat to the fundamental interest of society ‘does not have to be immediate’.<sup>133</sup> Nevertheless, it is a fact that the principles and exceptions

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<sup>128</sup> European Commission, ‘Free Movement of Capital: Commission scrutinises French law establishing authorisation procedure for foreign investments in certain sectors’ (n 111).

<sup>129</sup> Commission (EC), ‘Commission Staff Working Document: Special Rights in Privatised Companies in the Enlarged Union – a Decade Full of Developments’ (Brussels, 22 July 2005) 11  
[http://ec.europa.eu/finance/capital/docs/privcompanies\\_en.pdf](http://ec.europa.eu/finance/capital/docs/privcompanies_en.pdf) accessed 4 March 2016. For more information of cases concerning ‘golden shares’, see [http://ec.europa.eu/finance/capital/framework/court/index\\_en.htm](http://ec.europa.eu/finance/capital/framework/court/index_en.htm) accessed 3 March 2016.

<sup>130</sup> See *Gaz de France/Suez* (Case COMP/M.4180) Commission Decision C [2006] 5419 final. The French government has likewise reserved the right to retain a golden share in any restructuring of Areva, the French nuclear and renewable energy company, see US Department of State, ‘Investment Climate Statements for 2016-France and Monaco’ (n 112).

<sup>131</sup> See e.g., Case C 268/99 *Aldona Malgorzata Jany and Others v Staatssecretaris van Justitie* ECLI:EU:C:2001:616, para 59; Case C-260/89 *Elliniki Radiophonia Tileorassi AE v Dimotiki Etairia Pliroforissis and Sotirios Kouvelas* ECLI:EU:C:1991:254, para 24; Case C-114/97 *Commission of the European Communities v Kingdom of Spain* ECLI:EU:C:1998:519, paras 44- 6.

<sup>132</sup> Case C-244/11 *European Commission v Hellenic Republic* ECLI:EU:C:2012:694, paras 70-1. See also Case C -274/06 *European Commission v Kingdom of Spain* ECLI:EU:C:2008:86, para 50 and Case C-207/07 *European Commission v Kingdom of Spain* ECLI:EU:C:2008:428, para 53.

<sup>133</sup> In Case C-543/08 *European Commission v Portuguese Republic* ECLI:EU:C:2010:669, the Portuguese Republic argued:

86. ...Given that each Member State is obliged to guarantee the security of a regular and uninterrupted supply of electricity and natural gas, the Portuguese Republic can *legitimately* equip

to the freedom of establishment are merely applicable to the EU internal market. In other words, member states retain considerable policy discretion to review foreign investments and restrict the access of foreign investors from third countries for national security or public interests, regardless of public or private ownership. Until now, no case involving foreign SOEs has been blocked on grounds of national security.

Nevertheless, with the increase of FDI by SOEs in recent years, the European Commission has strengthened the monitoring of Chinese SOEs' M&As in Europe on grounds of competition policy.<sup>134</sup> Under the EU Merger Regulation, the European Commission has the jurisdiction to review foreign transactions qualified as 'concentrations' (i.e., widely covered mergers, acquisitions of control and the creation of full-function joint ventures) with an EU dimension (i.e., meeting certain turnover thresholds).<sup>135</sup> A foreign transaction falling under the Merger Regulation should be formally notified to the Commission and cannot be implemented unless and until the Commission declares it compatible with the internal market.<sup>136</sup> For SOE transactions, a problematic issue is whether or not the turnover of other SOEs should be taken into account when calculating the turnover of an SOE transaction. According to the EUMR and Recital 22, the Commission shall take into account SOEs 'making up an economic unit with independent power of decision'.<sup>137</sup> In practice, the Commission adopts a two-step approach: first, whether the SOEs have independent decision-making power, including in deciding strategy, business plans and budget; second, the possibility for the state to coordinate commercial conduct by imposing or facilitating coordination, such as the degree of interlocking directorships

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itself with the means required to guarantee the fundamental interest of security of supply *even if there is no imminent threat*. In that regard, since the risk of serious threats to the security of energy supply *cannot be excluded* and since such threats *are* by definition *sudden* and, in the majority of cases, *unforeseeable*, it is the duty of the Member State concerned to ensure that adequate mechanisms are put in place to *enable it to react rapidly and effectively to guarantee that the security of that supply is not interrupted*. [emphasis added]

<sup>134</sup> Du (n 77) 132.

<sup>135</sup> Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings (the EC Merger Regulation) (Text with EEA relevance) [2004] OJ L 24/1, Article 1 and Article 3.

<sup>136</sup> The EC Merger Regulation, Article 4 and Article 7.

<sup>137</sup> The EC Merger Regulation Article 5 (4); Commission Consolidated Jurisdictional Notice under Council Regulation (EC) No 139/2004 on the control of concentrations between undertakings [2008] OJ C95/1, paras 192 & 194. See also *EDF / CGN / NNB GROUP OF COMPANIES* (Case M.7850) Commission Decision C [2016] 1596 final, para 30.

or the existence of safeguards to prevent the sharing of commercially sensitive information between SOEs.<sup>138</sup>

Between 2011 and 2015, the European Commission applied the EUMR to takeovers and joint venture transactions involving Chinese SOEs.<sup>139</sup> Most recently, the European Commission published its decision clearing the joint acquisition of NNB companies by EDF and a Chinese State-owned energy company CGN.<sup>140</sup> In the decision, the European Commission considered that the Central State Assets Supervision and Administration Commission (SASAC) has an influence on the CGN's major decision making, and that the CGN does not enjoy autonomy from the state in deciding major matters like strategy, business plan, senior manager appointment or budget.<sup>141</sup> Moreover, the Commission concluded that within the energy sector and in particular the nuclear industry, the Chinese State via Central SASAC could require or facilitate coordination between Chinese SOEs.<sup>142</sup> As a result, the European Commission concluded that the CGN and other Chinese SOEs in the energy industry should not be deemed to have an independent power of decision from Central SASAC, and that the turnover of all these companies should be aggregated.<sup>143</sup>

It seems to have become a general practice that the European Commission *presumes* that all Chinese SOEs in the same sector are one economic unit, 'the China Inc.', and then assesses the competition implications, even in a worst scenario approach, i.e., taking into account *all* Chinese SOEs, including central SOEs and regional SOEs, in the same sector.<sup>144</sup> Although the previous cases do not create a binding precedent for

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<sup>138</sup> Ibid, paras 31-2. See also *EDF/SEGEBEL* (Case COMP/M.5549) Commission Decision C [2009] 9059, paras 92-3; *CNRC/Pirelli* (Case COMP/M.7643) Commission Decision C [2015] 4608 final, para 8 et seq; *DSM/SINOCHEN/JV* (Case COMP/M.6113) Commission Decision C [2011] 3641 final, paras 10-3.

<sup>139</sup> Kyriakos Fountoukakos et al, 'European Commission Seeks Harmonization on Merger Control Reviews of Chinese State-Owned Enterprises' (18 July 2013, retrieved 1 October 2015) <<http://careers.herbertsmith.com/insights/legal-briefings?page=25>> accessed 5 March 2017.

<sup>140</sup> *EDF/CGN/NNB Group of Companies* (Case M.7850) Commission Decision C [2016] 1596 final.

<sup>141</sup> Ibid, paras 37-42.

<sup>142</sup> Ibid, paras 43-48.

<sup>143</sup> Ibid, para 49.

<sup>144</sup> For example, in the CGN/EDF decision, the European Commission left the question whether local SASAC shall be considered as forming a single market as the turnovers of Chinese SOEs controlled by Central SASAC meet the thresholds of the Merger Regulation, *ibid*, para 50. See also Du (n 77) 135.

future transactions involving SOEs, and considering that the Commission shall conduct the merger review on a case-by-case assessment, the European Commission's decisions do suggest that Chinese SOEs may be forced to file for EU merger clearance, regardless of their size in Europe.<sup>145</sup>

Notably, the main concern of an antitrust review is whether or not transactions involving foreign SOEs potentially affect fair competition, rather than whether the foreign acquirer is owned by a foreign government. Nevertheless, the EU merger rule could constitute an extra barrier of market access for Chinese SOEs. For example, the notification process may be particularly burdensome for Chinese SOEs, since the information required to be submitted might be gargantuan and the preparation time for notification and assessment would potentially be longer than usual.<sup>146</sup>

### 3.2.5 China: FDI Regime Reform and FTZ Review

The establishment of China's foreign investment legal regime began in the 1980s. It is based on three central laws: The China-Foreign Equity Joint Venture Enterprise Law, the China-Foreign Cooperative Joint Venture Enterprise Law, and the Foreign-Invested Enterprise Law. Accordingly, foreign investors are required to obtain approvals for their investment projects from multiple government agencies, which review the foreign investment on a case-by-case basis.<sup>147</sup> In respect of market access, China sets limits on foreign control via the Catalogue for the Guidance of Foreign Investment in Industries (the 'Foreign Investment Catalogue'), most recently revised in March 2015, and maintained by the Ministry of Commerce (MOFCOM) and the National Development and Reform Commission (NDRC). Investment is 'restricted'

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<sup>145</sup> Michelle Price, 'Chinese state-owned companies face greater scrutiny of EU deals after ruling' *Reuters* (12 Jun 2016) <<http://www.reuters.com/article/us-china-eu-m-a-idUSKCN0YZ00U>> accessed 27 Feb 2017. For more discussion see Bill Batchelor and Tom Jenkins, 'EU merger decision shines light on state-owned enterprises' *International Law Office* (18 August 2016) <<http://www.internationallawoffice.com/Newsletters/Competition-Antitrust/European-Union/Baker-McKenzie-LLP/EU-merger-decision-shines-light-on-state-owned-enterprises>> accessed 27 Feb 2017.

<sup>146</sup> Du (n 77) 136; Adrian Emch, 'EU merger control complications for Chinese SOE transactions' *Kluwer Competition Law Blog* (27 May 2017) <<http://kluwercompetitionlawblog.com/2016/05/27/eu-merger-control-complications-for-chinese-soe-transactions/>> accessed 10 March 2017.

<sup>147</sup> For further discussion on China's approval process, see US Chamber of Commerce (n 5).



and ‘prohibited’ in sectors that China deems sensitive to national security or that do not meet the goal of China’s economic development plan. According to the NDRC, the 2015 Catalogue reduced the number of restricted industries from 79 to 38. Prohibited industries were reduced from 38 to 36, with manufacturing, infrastructure, real estate, energy, e-commerce and information technology, logistics and finance among the beneficiaries.<sup>148</sup> Notably, in June 2017, the NDRC and the MOFCOM released the 2017 version of the Catalogue, which introduced a national negative list to guide foreign investment and reduced the restrictive measures from 93 to 63.<sup>149</sup>

Moreover, foreign investors are required to obtain approvals for their investment projects and for the purpose of establishing an enterprise in China. In 2004, the State Council issued its Decision on Investment Regime Reform and the Catalogue of Investment Projects Subject to Government Ratification (the ‘Ratification Catalogue’). All proposed foreign investment projects in China must be submitted for ‘review and ratification’ by the NDRC or provincial or local Development and Reform Commissions.<sup>150</sup> In the 2013 Ratification Catalogue, however, the government narrowed the scope of NDRC ratification under which foreign investments unlisted in the catalogue require only ‘filing for record’ with the local NDRC.<sup>151</sup> Most recently, the government released 2015 Ratification Catalogue, replacing the 2014 edition and continuously reducing the number of projects requiring ratification from central government and delegated ratification authority to local government.<sup>152</sup>

While China’s FDI regime is criticised for being restrictive and inefficient and for favouring national champions,<sup>153</sup> it has made some significant developments in

<sup>148</sup> For the official text of the 2015 Foreign Investment Catalogue, see

<<http://images.mofcom.gov.cn/wzs/201503/20150317134821983.pdf>> accessed 7 March 2017.

<sup>149</sup> For the official text of the 2017 Catalogue, see <<http://www.gov.cn/xinwen/2017-06/28/5206424/files/e4489bbd621542a480ff4c45c42fa202.pdf>> accessed 28 August 2017.

<sup>150</sup> NDRC, Decision of the State Council on Reforming the Investment System, No.20 [2004] of the State

Council, 16 July 2004. For the 2004 Catalogue of Investment Projects subject to Government Ratification, see

<[http://www.sdpc.gov.cn/fzgggz/gdzctz/tzfg/200510/t20051010\\_44895.html](http://www.sdpc.gov.cn/fzgggz/gdzctz/tzfg/200510/t20051010_44895.html)> accessed 21 July 2016.

<sup>151</sup> For the official text of 2013 Ratification Catalogue, see

<<http://www.mofcom.gov.cn/article/b/g/201404/20140400545285.shtml>> accessed 7 March 2016.

<sup>152</sup> For the official text of 2016 Ratification Catalogue, see

<[http://www.gov.cn/zhengce/content/2016-12/20/content\\_5150587.htm](http://www.gov.cn/zhengce/content/2016-12/20/content_5150587.htm)> accessed 7 March 2016.

<sup>153</sup> See e.g., US Department of State, ‘Investment Climate Statement for 2016- China’ (2016)

recent years to reform the FDI regime and expand market access to foreign investors. In November 2013, the Chinese Communist Party issued a decision to broaden foreign investment access in China and extend national treatment to the pre-establishment phase based on a ‘negative list’, and to set up more free trade zones like the Shanghai pilot free trade zone (FTZ).<sup>154</sup> In April 2015, the State Council published a revised ‘Negative List’ to regulate trade and investment in all four FTZs, including Shanghai, Tianjin, Guangdong and Fujian, which reduced the number of excluded items to 122 from 190 in the 2013 List.<sup>155</sup> On 5 June 2017, the State Council released an updated foreign investment negative list for 11 FTZs, cutting 10 categories and 27 measures in the fields of aviation manufacturing, waterway transportation, banking services and education.<sup>156</sup> According to the State Council’s circular, fields not covered by the new negative list included national security, public order, public culture, financial regulation and government purchases following existing regulations. Meanwhile, a foreign investment permit is necessary for the non-prohibited investment sectors on the list.<sup>157</sup>

Most importantly, in January 2015, the MOFCOM invited comments for a Draft Foreign Investment Law, which unifies regulations and abolishes the case-by-case approval of foreign investment in favour of a system that would treat the FDI the same as domestic investment, except for those in sectors detailed in a ‘negative list’.<sup>158</sup> The Draft Law, if adopted, would significantly change the regulatory

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<<https://www.state.gov/e/eb/rls/othr/ics/investmentclimatestatements/index.htm#wrapper>> accessed 12 September 2017.

<sup>154</sup> For an English version of the Third Plenum decision, see

<[http://www.china.org.cn/china/third\\_plenary\\_session/2013-11/16/content\\_30620736.htm](http://www.china.org.cn/china/third_plenary_session/2013-11/16/content_30620736.htm)> accessed 6 March 2017.

<sup>155</sup> For the official text of 2015 Negative List, see <[http://www.gov.cn/zhengce/content/2015-04/20/content\\_9627.htm](http://www.gov.cn/zhengce/content/2015-04/20/content_9627.htm)> accessed 8 March 2017.

<sup>156</sup> For the official text of 2017 Negative List, see <[http://www.gov.cn/zhengce/content/2017-06/16/content\\_5202973.htm](http://www.gov.cn/zhengce/content/2017-06/16/content_5202973.htm)> accessed 28 August 2017. China now has 11 FTZs in Shanghai, Fujian, Guangdong, Tianjin, Chongqing, Henan, Hubei, Liaoning, Shaanxi, Sichuan and Zhejiang.

<sup>157</sup> The State Council of China, ‘China introduces new negative list for FTZ foreign investment’ (16 June 2017) <[http://english.gov.cn/policies/latest\\_releases/2017/06/16/content\\_281475687826506.htm](http://english.gov.cn/policies/latest_releases/2017/06/16/content_281475687826506.htm)> accessed 28 August 2017.

<sup>158</sup> For the Draft Foreign Investment Law (in Chinese) see

<<http://tfs.mofcom.gov.cn/article/as/201501/20150100871010.shtml>> accessed 8 March 2017.

For an unofficial English version see

<[https://www.uschina.org/sites/default/files/2015%20Draft%20Foreign%20Investment%20Law%20of%20the%20People%27s%20Republic%20of%20China\\_JonesDay\\_0.pdf](https://www.uschina.org/sites/default/files/2015%20Draft%20Foreign%20Investment%20Law%20of%20the%20People%27s%20Republic%20of%20China_JonesDay_0.pdf)> accessed 7 March 2017.

landscape for the foreign investor and constitute a milestone in the deregulation of foreign investments. In September 2016, the National People's Congress passed its Decision to Amend Four Laws including the Wholly Foreign-Owned Enterprise Law of the People's Republic of China, which replaced the prior approval-filing with a record-filing for foreign investment, unless the project concerned falls within the scope of the negative list.<sup>159</sup> Instead of publishing a nation-wide negative list, on 8 October 2016, however, the State Council authorised the NDRC and the MOFCOM to jointly release Bulletin 22/2016 as a temporary arrangement. This provided special administrative measures for access of foreign-invested enterprises (FIEs) subject to the 2015 Foreign Investment Catalogue.<sup>160</sup> On the same date, MOFCOM published the Interim Measures for the Recordation Administration of the Formation and Modification of Foreign-Funded Enterprises, implementing the MOFCOM record-filing procedures.<sup>161</sup>

In addition, proposed foreign M&As are subject to an anti-monopoly review by the MOFCOM. Further, Article 31 of China's Anti-Monopoly Law requires a separate national security review in cases where a foreign M&A of domestic enterprise poses national security concerns.<sup>162</sup> Article 12 of the MOFCOM's Rules on M&As of Domestic Enterprise by Foreign Investment stipulates that parties are required to report the transaction to MOFCOM if a foreign investor obtains actual control, via mergers or acquisitions, of a domestic enterprise in a major industry which has or may have an impact on national economic security.<sup>163</sup> In February 2011, China

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<sup>159</sup> The four foreign investment laws include Wholly Foreign-owned Enterprise Law of the People's Republic of China, Sino-Foreign Equity Joint Venture Enterprise Law of the People's Republic of China, Sino-Foreign Cooperative Joint Venture Enterprise Law of the People's Republic of China, and Law of the People's Republic of China on the Protection of Investment of Taiwan Compatriots 1994. NPC, 'Decision to Amend Four Laws including the Law of the People's Republic of China on Wholly Foreign-Owned Enterprises' (3 September 2016) <[http://www.npc.gov.cn/npc/xinwen/2016-09/03/content\\_1996747.htm](http://www.npc.gov.cn/npc/xinwen/2016-09/03/content_1996747.htm)> accessed 8 March 2017.

<sup>160</sup> For the official document see <<http://www.mofcom.gov.cn/article/b/f/201610/20161001404973.shtml>> accessed 8 March 2017.

<sup>161</sup> For the official document see <<http://www.mofcom.gov.cn/article/b/f/201610/20161001404974.shtml>> accessed 8 March 2017. For more discussion on MOFCOM FIE record-filing measures, see Practical Law China, 'MOFCOM Finalises FIE Record-filing Measures' (12 Oct 2016) <<http://www.mofcom.gov.cn/article/b/f/201610/20161001404973.shtml>> accessed 8 March 2017.

<sup>162</sup> For the official text of Anti-Monopoly Law of the People's Republic of China see <[http://www.gov.cn/flfg/2007-08/30/content\\_732591.htm](http://www.gov.cn/flfg/2007-08/30/content_732591.htm)> accessed 8 March 2017.

<sup>163</sup> For the full text of Regulations for M&As of Domestic Enterprise by Foreign Investors, see <<http://english.mofcom.gov.cn/article/policyrelease/domesticpolicy/200610/20061003434565.html>> accessed 8

released the State Council Notice Regarding the Establishment of a Security Review Mechanism for Foreign Investors Acquiring Domestic Enterprises which established an interagency Joint Conference. This was led by the NDRC and the MOFCOM, with the authority to review and block foreign mergers or acquisitions of domestic firms that it believes pose a threat to national security of China. It assessed impacts on national defence, national economic stability, fundamental ‘social orders’ and the research and development capability of key technologies in relation to national security by foreign transactions.<sup>164</sup>

In January 2015, China introduced a formal national security review mechanism in its Draft Foreign Investment Law, where foreign investors, governmental review agencies and third parties (such as other governmental agencies, industry associations and companies in the same industry) can invoke a national security review.<sup>165</sup> Like the CFIUS review, the Draft included a similarly non-exhaustive list of elements relating to national security, including (but only as one factor) whether or not the foreign investment is controlled by a foreign government.<sup>166</sup> In April 2015, China released the Interim Measures on the National Security Review of Foreign Investment in pilot FTZs.<sup>167</sup> However, some US business associations have expressed their concerns about China’s ‘overly broad’ definition of national security, specifically including economic security, which they describe as ‘heavily skewed in favour of protecting national interests that fall outside the widely accepted scope of essential national security concerns’ and ‘likely to have a significant adverse impact

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March 2017.

<sup>164</sup> MOFCOM, ‘The State Council Notice Regarding the Establishment of a Security Review Mechanism for Foreign Investors Acquiring Domestic Enterprises’ (2011)

<<http://www.mofcom.gov.cn/aarticle/b/f/201102/20110207403117.html>> accessed 21 July 2016.

<sup>165</sup> See Article 1 of Chapter 4 of the Draft Foreign Investment Law (n 158).

<<http://tfs.mofcom.gov.cn/article/as/201501/20150100871010.shtml>> accessed 21 July 2016.

<sup>166</sup> Draft Foreign Investment Law, Ch 4, Article 10. The elements include: a) impacts military security, b) impacts on research and development capabilities of key technologies in relation to national security, c) impacts on the technological leadership in the fields in relation to national security, d) impacts on dual-use items subject to import and export and technical diffusion, e) impacts on critical infrastructures and technologies, f) impacts on information and network security, g) impacts on long-term demands for energy, food and other key resources, h) whether the foreign investment is controlled by foreign governments; i) impacts on national economic stabilities; j) impacts on social public interests and public order; and k) other elements that the Joint Conference considered necessary.

<sup>167</sup> For the official text of Interim Measures see

<<http://www.mofcom.gov.cn/article/b/g/201506/20150601018472.shtml>> accessed 25 July 2016.

on the flow of foreign investment into China'.<sup>168</sup> Until now, there are no publications concerning the implementation of national security reviews in the pilot FTZs, and the formal national security review mechanism is still under consideration in the Draft Foreign Investment Law. Thus, China's approach to national security remains unclear.

While China's FDI regime does not discriminate foreign investors on the basis of ownership,<sup>169</sup> it has been criticised for favouring domestic firms, especially national SOEs.<sup>170</sup> The December 2006 Guiding Opinions Concerning the Advancement of Adjustments of State Capital and the Restructuring of State-Owned Enterprises called on China to consolidate and develop its state-owned economy, including enhancing its control and influence in 'vital industries and key fields relating to national security and national economic lifelines'.<sup>171</sup> The document defined 'vital industries and key fields' as 'industries concerning national security, major infrastructure and important mineral resources, industries that provide essential public goods and services, and key enterprises in pillar industries and high-tech industries'.<sup>172</sup> In 2012, the 18<sup>th</sup> National Congress of the Communist Party of China called for comprehensive reform of SOEs, improvements in the mechanisms for managing all types of state assets, and more investment of state capital in major industries, and key fields that comprise the lifeline of the economy and are vital to national security.<sup>173</sup> While stating that public ownership plays a dominant role in China's economic system, the Decision of the CCCPC on Some Major Issues

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<sup>168</sup> US Chamber of Commerce, American Chamber of Commerce in China, and American Chamber of Commerce in Shanghai, 'Joint Submission to the State Council on the Trial Measures for the National Security Review of Foreign Investments in China's Pilot Free Trade Zones and Revised Free Trade Zone Negative List', cited in Lauren Gloudeman and Nargiza Salidjanova, 'Policy Considerations for Negotiating a U.S.-China Bilateral Investment Treaty' (Economic and Security Review Commission Staff Research Report 2016) 13 <<https://www.uscc.gov/Research/policy-considerations-negotiating-us-china-bilateral-investment-treaty>> accessed 12 September 2017.

<sup>169</sup> But according to the Draft Foreign Investment Law, 'whether the foreign investment is controlled by foreign governments' is a factor for national security consideration by the Joint Conference, see the Draft Foreign Investment Law, Ch 4, Article 10.

<sup>170</sup> US Department of State, 'Investment Climate Statement for 2016- China' (n 153).

<sup>171</sup> For the official text of the Guiding Opinion see <<http://www.sasac.gov.cn/gzjg/xcgz/200612180138.htm>> accessed 8 March 2017.

<sup>172</sup> *ibid.*

<sup>173</sup> 'Report of Hu Jintao to the 18th CPC National Congress' *China.org.cn* (8 November 2012) <[http://www.china.org.cn/china/18th\\_cpc\\_congress/2012-11/16/content\\_27137540.htm](http://www.china.org.cn/china/18th_cpc_congress/2012-11/16/content_27137540.htm)> accessed 8 March 2017.

Concerning Comprehensively Deepening the Reform called for a ‘mixed ownership’ economic structure which would allow for private and state-owned businesses to co-exist in the domestic economy, and proposed greater balance between private and state-owned businesses.<sup>174</sup> The Decision’s resolution was that state-owned capital investment operations should serve state strategic goals and invest more in key industries and areas that are vital to national security and are the lifeblood of the economy. The 2013 Third Plenum reform pronouncements suggest that China will attempt to reform SOEs by improving SOE management structures, emphasising the importance of SOEs meeting financial goals and taking steps to bring private capital into sectors traditionally monopolised by SOEs.<sup>175</sup> In 2015, China issued the Guiding Opinions on Deepening the Reform of SOEs where the State Council instituted a system for classifying SOEs as public services or commercial enterprises, allowing the government to reduce support for commercial enterprises competing with private firms and instead channel resources toward public service SOEs.<sup>176</sup> In practice, the government is still working on its SOE reform, and the terms of the implementation have yet to be clarified.<sup>177</sup>

### 3.2.6 Concluding Observations

What can we learn from the review of domestic policies and legal regimes on foreign investors and what are their implications for the access of SOE investors? On the one hand, national security and other national interests have become a significant part of national investment policies where more countries have adopted or amended legislation to strengthen the review of foreign investments on the grounds of national security and related concerns (Table 3.1).<sup>178</sup> Although the mechanism for FDI screening seldom targets foreign SOEs, the process is intended to address host states’ concerns over SOE investments, such as national security and anti-competition concerns, and to restrict access to certain strategic industries under foreign state

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<sup>174</sup> For the full text of the Decision see <[http://www.china.org.cn/chinese/2014-01/17/content\\_31226494.htm](http://www.china.org.cn/chinese/2014-01/17/content_31226494.htm)> accessed 8 March 2017.

<sup>175</sup> US Department of State, ‘Investment Climate Statement for 2016- China’ (n 153).

<sup>176</sup> *ibid.* For the 2015 Guiding Opinions see <[http://news.xinhuanet.com/politics/2015-09/13/c\\_1116547305.htm](http://news.xinhuanet.com/politics/2015-09/13/c_1116547305.htm)> accessed 8 March 2017.

<sup>177</sup> *ibid.*

<sup>178</sup> UNCTAD, *WIR 2016* (n 2), 95–6.

ownership. In this regard, national investment reviews, especially the national security review, pose potential obstacles for SOE investors.

On the other hand, domestic approaches to the regulation and review of foreign investments entail diverging entry conditions for different countries in respect of similar, or even identical, economic activities.<sup>179</sup> As noted, the US and Canada have established independent and comprehensive national security reviews, while Australia approves foreign investments through a national interest test where national security is a crucial factor for consideration. Meanwhile, the US, Canada and Australia have imposed stricter rules on SOE investors, such as a required 45-day investigation in the US, a lower threshold of review in Canada and a mandatory review for all SOE investments in Australia. In contrast, EU regulations do not distinguish foreign investments on the basis of ownership. Recently, both the member states and the European Commission may scrutinise foreign investments for national security or public order where whether the foreign investor is controlled by the government is a factor to be considered in determining the effect of FDI on security or public order. In spite of member states' control, the EU further regulates foreign investments on grounds of competition policy. China has recently relaxed its regulations on foreign investments in the Draft Foreign Investment Law, *inter alia*, adopting a negative list for foreign investment and providing a detailed national security review similar to the US. China has also published the relevant rules in pilot FTZs. Therefore, SOE investors may face not only different but also additional barriers to entry into certain countries.

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<sup>179</sup> *ibid* 94.

Table 3.1 FDI regulatory approaches for national security and related reasons in selective countries

|                    | Full and/or partial FDI restriction in a given sector, area or activity | State monopoly | Review mechanism in pre-defined sectors and/or activities | Cross-sectoral review mechanism |
|--------------------|---|----------------|---|---------------------------------|
| Algeria            | x   | x              |   |                                 |
| Argentina          | x   |                | x   |                                 |
| Brazil             | x   | x              | x   |                                 |
| Canada             |   |                |   | x                               |
| Chile              | x   |                | x   |                                 |
| China              | x   | x              | x   |                                 |
| Egypt              | x   | x              |   |                                 |
| Ethiopia           | x   | x              | x   |                                 |
| Finland            |   | x              | x   | x                               |
| France             |   | x              | x   |                                 |
| Germany            |   | x              | x   | x                               |
| India              | x   |                | x   |                                 |
| Indonesia          | x   |                | x   |                                 |
| Italy              |   | x              | x   |                                 |
| Japan              |   |                | x   |                                 |
| Korea, Rep. of     | x   | x              | x   | x                               |
| Mexico             | x   | x              | x   | x                               |
| Myanmar            | x   | x              |   | x                               |
| Poland             |   |                | x   |                                 |
| Russian Federation | x   | x              | x   |                                 |
| Turkey             | x   | x              | x   |                                 |
| United Kingdom     |   |                | x   | x                               |
| United States      | x   |                |   | x                               |

Source: UNCTAD, *WIR 2016*

X = Existing restriction.

Beyond these apparent differences, however, there are three observations on domestic regulations that may have implications for SOE investors. Firstly, while many countries have addressed foreign investment screening on the grounds of national security or related national interests, they have never provided a precise or exhaustive definition of what ‘national security’ or ‘national interest’ is.<sup>180</sup> The US and Canada, for example, have attempted to clarify the key term by providing a list of factors for national security consideration, but the list is an illustrative one, and the concept of national security is still broad and undefined. This is to say that other factors may also be considered a threat to national security, and the host state will

<sup>180</sup> *ibid* 94.



retain considerable discretion in determining the issue. Another problem here is whether a national security review shall take into account economic interests. As mentioned earlier, additional factors for national security considerations, added through Pub. L. 11-49, have incorporated economic elements into the Exon-Florio process, and refocused CFIUS's reviews on considering the 'broader rubric of economic security'.<sup>181</sup> Furthermore, the 2012 Report of the US-China Economic and Security Review Commission suggested adding a 'net economic benefit' test to the existing national security test that CFIUS administers.<sup>182</sup> Hence, some countries in practice take into account whether or not a foreign transaction in question has any negative impact on national economy, even though there is no explicit reference to economic criteria in domestic tests. These facts indicate that host governments may decide the admission on grounds of broader economic considerations. In such a case, foreign SOEs may be subject to a closer scrutiny as they are sparking concerns over economic and security implications. In this regard, host states may restrict or block foreign SOE transactions on grounds of economic interests in national security reviews.

Secondly, screening of FDI for national security and other national interests is, to a great extent, intended to restrict or exclude foreign ownership in the critical infrastructure and in strategically important industries. As the notions of national security and national interest have evolved during past years, the vital industries concerned have been expanded to encompass not only traditional security and national defence activities (e.g., military and military-related businesses), but also to cover a wide range of critical infrastructures (e.g., electricity, water and gas distribution, health and education services, transportation, communications), and vital strategic sectors (e.g., natural resources).<sup>183</sup> As a result, national security stretches beyond military security and comprises various policy concerns, such as

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<sup>181</sup> Jackson (n 6) 18.

<sup>182</sup> US-China Economic and Security Review Commission, '2012 Annual Report To Congress' (2012) 22 <[https://www.uscc.gov/sites/default/files/annual\\_reports/2012-Report-to-Congress.pdf](https://www.uscc.gov/sites/default/files/annual_reports/2012-Report-to-Congress.pdf)> accessed 12 September 2017.

<sup>183</sup> UNCTAD 94-5; Frédéric Wehrlé and Joachim Pohl, 'Investment Policies Related to National Security: A Survey of Country Practices' (2016) 2016/02 22-4 <<http://dx.doi.org/10.1787/5jlwrrf038nx-en>> accessed 12 September 2017.

economic, energy, environment, food and cyber security, and so on.<sup>184</sup> Although such concerns do not target foreign SOEs, it is unsurprising that host governments are reluctant to allow another foreign government to access its key or sensitive sectors. For example, the ChemChina - Syngenta deal has raised concerns on food and national security because the food and agriculture sectors are part of the nation's critical infrastructure.<sup>185</sup> As more sectors are characterised as critical industries or of strategic importance to national security and related national interests, acquisitions by foreign SOEs in these sectors are likely to be subject to tight scrutiny. For instance, the UK's Prime Minister Theresa May in July 2016 delayed approving the Hinkley Point C project due to security concerns about Chinese SOE' involvement in sensitive sectors.<sup>186</sup> Also, the US Intelligence Community warned that there may be a coordinated effort by foreign countries to acquire US 'critical technology companies' and in December 2016, US President Obama blocked a takeover of German semiconductor company Aixtron by a Chinese company with government ties.<sup>187</sup>

Thirdly, investments by Chinese firms, especially SOEs, are raising concerns. As a result, Chinese SOEs, and maybe broadly all Chinese investors, are facing tougher foreign investment reviews. The *Financial Times* reported that between 2015 and 2016 nearly \$40 bn in planned Chinese acquisitions were delayed by Western countries due to concerns over competition and security issues.<sup>188</sup> The US, for example, has been reviewing a growing number of foreign investments for national security reasons, with investments from China the leading targets (Table 3.2).<sup>189</sup> In

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<sup>184</sup> See e.g., National Security Strategy and Strategic Defence and Security Review 2015: A Secure and Prosperous United Kingdom, November 2015; 'Presidential Policy Directive - Critical Infrastructure Security and Resilience' (n 45).

<sup>185</sup> Shawn Donnan, 'Grassley warns on ChemChina-Syngenta deal' *Financial Times* (23 March 2016) <<https://www.ft.com/content/18898bcc-f132-11e5-a609-e9f2438ee05b>> accessed 13 March 2017.

<sup>186</sup> Some argued that 'Beijing could build weaknesses into computer systems that would allow them to 'shut down Britain's energy production at will'', see George Parker and Luck Hornby, 'Hinkley Point review signals UK rethink on Chinese investment' *Financial Times* (29 July 2016) <<https://www.ft.com/content/2af4e1c8-5562-11e6-befd-2fc0c26b3c60>> accessed 13 March 2017.

<sup>187</sup> Jonathan Masters and James McBride, 'Foreign Investment and U.S. National Security' *Council on Foreign Relations* (14 December 2016) <<http://www.cfr.org/foreign-direct-investment/foreign-investment-us-national-security/p31477>> accessed 13 March 2017.

<sup>188</sup> James Kynge, 'Nearly \$40bn in Chinese acquisitions pushed back by west' *Financial Times* (24 October 2016) <<https://www.ft.com/content/4cf027ea-977c-11e6-a1dc-bdf38d484582>> accessed 13 March 2017.

<sup>189</sup> Shawn Donnan, 'US reviews of investments made by China increase' *Financial Times* (20 February 2016),

2012, the House Permanent Select Committee on Intelligence released a report on the ‘counterintelligence and security threat posed by Chinese telecommunications companies doing business in the United States’ where the Committee offered recommendations to CFIUS.<sup>190</sup> These included recommendations that:

- The CFIUS must block acquisitions, takeovers, or mergers involving Huawei and ZTE given the threat to US national security interests.
- Committees of jurisdiction in the US Congress should consider potential legislation to better address the risk posed by telecommunications companies with nation-state ties or otherwise not clearly trusted to build critical infrastructure.<sup>191</sup>

Table 3.2 Country of foreign investor and industry reviewed by CFIUS, 2012-2014

| Country        | Manufacturing | Finance,<br>Information,<br>and Services | Mining,<br>Utilities, and<br>Construction | Wholesale<br>Trade and<br>Retail Trade | Total      |
|----------------|---------------|--|---|--|------------|
| China          | 33            | 13                                       | 19  | 3                                      | 68         |
| United Kingdom | 20            | 16                                       | 5   | 4                                      | 45         |
| Canada         | 4             | 6  | 20  | 10                                     | 40         |
| Japan          | 18            | 10                                       | 5   | 4                                      | 37         |
| France         | 12            | 8  | 0   | 3                                      | 21         |
| Germany        | 10            | 7  | 0   | 0                                      | 17         |
| Switzerland    | 13            | 2  | 0   | 0                                      | 15         |
| Netherlands    | 4             | 9  | 2   | 0                                      | 15         |
| Singapore      | 2             | 3  | 3   | 3                                      | 11         |
| Israel         | 8             | 2  | 0   | 0                                      | 10         |
| South Korea    | 4             | 4  | 2   | 0                                      | 10         |
| <b>Total</b>   | <b>151</b>    | <b>106</b>                               | <b>68</b>                                 | <b>33</b>                              | <b>356</b> |

Source: Annual Report to Congress, CFIUS, February 2016

Moreover, in the 2012 Report of the US - China Economic and Security Review Commission, US industries, lawmakers and government officials expressed growing worries about the ‘potential economic distortions and national security concerns arising from [China’s] system of state-supported and state-led economic growth’; economic concerns center on the possibility that state-backed Chinese companies

<<https://www.ft.com/content/6ef4ffdc-d75b-11e5-969e-9d801cf5e15b>> accessed 13 March 2017.

<sup>190</sup> For the full report see US House of Representatives, ‘Investigative Report on the U.S. National Security Issues Posed by Chinese Telecommunications Companies Huawei and ZTE’ (2012)

<[https://intelligence.house.gov/sites/intelligence.house.gov/files/documents/huawei-zte investigative report \(final\).pdf](https://intelligence.house.gov/sites/intelligence.house.gov/files/documents/huawei-zte%20investigative%20report%20(final).pdf)> accessed 12 September 2017.

<sup>191</sup> *ibid.*

choose to invest ‘based on strategic rather than market-based considerations’ and are free from the constraints of market forces because of generous state subsidies.<sup>192</sup> Accordingly, the Commission recommended that Congress amend the CFIUS review to (1) require a mandatory review of all controlling transactions by Chinese state-owned and state-controlled companies investing in the United States; (2) add a net economic benefit test to the existing national security test that CFIUS administers; and (3) prohibit investment in a US industry by a foreign company whose government prohibits foreign investment in that same industry.<sup>193</sup> Although CFIUS makes decisions on a case-by-case basis, the US policy toward Chinese investments may become more aggressive in the future. For example, immediately following the election of US President Donald Trump, the US - China Economic and Security Review Commission recommended Congress ‘authorising the CFIUS to bar Chinese SOEs from acquiring or otherwise gaining control of US companies’, particularly considering the ‘high risk’ of Chinese SOEs posing a detriment to US national security.<sup>194</sup> In particular, the 2016 report stated that:

...All Chinese companies’ economic activity - not just the activity of state-owned firms - is conducted in support of the state’s goals and policies. This is particularly true for Chinese firms operating in strategic sectors... The CCP continues to use SOEs as the primary economic tool for advancing and achieving its national security objectives. Consequently, there is an inherently high risk that *whenever* an SOE acquires or gains effective control of a US company, it will use the technology, intelligence, and market power it gains in the service of the Chinese state to the detriment of US national security.<sup>195</sup> (emphasis added)

As mentioned already, in December 2016, President Obama blocked the Aixtron transaction.<sup>196</sup> After that, twenty-two House lawmakers wrote to the Treasury

<sup>192</sup> US-China Economic and Security Review Commission, ‘2012 Annual Report To Congress’ (n 182) 95.

<sup>193</sup> *ibid* 22.

<sup>194</sup> Jessica Dye, ‘US panel calls for ban on acquisitions by China state firms’ *Financial Times* (17 November 2016) <<https://www.ft.com/content/4393d61f-77ec-3bff-843c-cdf368664297>> accessed on Jan 9, 2017.

<sup>195</sup> US - China Economic and Security Review Commission, ‘2016 Annual Report To Congress’ (n 64) 91–136.

<sup>196</sup> William Mauldin, ‘Obama Blocks Chinese Bid for Technology Firm Aixtron’ *The Wall Street Journal* (3 December 2016) <<https://www.wsj.com/articles/obama-blocks-chinese-bid-for-technology-firm-aixtron-1480716287>> accessed 28 August 2017. This is the third transaction being blocked by the US President based on the CFIUS recommendation. The first case occurred in 1990 where President Bush directed a Chinese SOE,

Secretary to urge Obama to reject the Lattice Semiconductor deal backed by investors in China.<sup>197</sup>

Although Chinese investments have so far been subject to a less harsh regulatory processes in European countries, the FDI regime may become tougher in the future. As mentioned earlier, transactions by Chinese SOEs may face lengthy and burdensome merger regulations in the EU. In October 2016, the German government withdrew approvals for a €670m takeover of computer chip manufacturer Aixtron by a group of Chinese investors on public security concerns.<sup>198</sup> In April 2017, the EU approved the Syngenta acquisition by a China SOE, ChemChina, for \$43 billion in cash of antitrust issue, but required the SOE to divest ‘a significant part’ of its Adama unit’s pesticide business.<sup>199</sup> In June, President Macron of France, together with allies in Germany and Italy, called for the creation of an EU mechanism to control foreign takeovers of important industries, which reflected pressure to curb takeovers by Chinese state-based companies in Europe.<sup>200</sup>

While domestic regulators do not expressly prohibit an investment simply because it originates from an SOE, they retain almost unlimited discretion to do so, relying on a

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CATIC, to divest its acquisition of MAMCO Manufacturing; the second case was in 2012 where President Obama directed the Ralls Corporation to divest itself of an Oregon wind farm project.

<sup>197</sup> The acquirer, Canyon Bridge, is concerned by the lawmakers to be ‘directly affiliated with the government of China’ and further to be ‘a legal construction intended to obfuscate the involvement of numerous PRC SOEs’, see William Mauldin, ‘U.S. Lawmakers Urge Rejection of China-Linked Purchase of Lattice Semiconductor’ *The Wall Street Journal* (5 December 2016) <<http://www.wsj.com/articles/u-s-lawmakers-urge-rejection-of-china-linked-purchase-of-lattice-semiconductor-1480988292>> accessed 12 September 2017.

<sup>198</sup> Guy Chazan, ‘Germany withdraws approval for Chinese takeover of tech group’ *Financial Times* (24 October 2016) <<https://www.ft.com/content/f1b3e52e-99b0-11e6-8f9b-70e3cabccfae>> accessed 13 March 2017.

<sup>199</sup> Aoife White, ‘ChemChina Wins EU Approval for \$43 Billion Syngenta Deal’ *Bloomberg* (5 April 2017) <<https://www.bloomberg.com/news/articles/2017-04-05/chemchina-wins-eu-approval-for-43-billion-syngenta-deal>> accessed 28 August 2017. Just one day before the EU’s approval, the US antitrust authorities also cleared the proposed acquisition on condition that ChemChina divested three products.

<sup>200</sup> However, this proposal was opposed by some member states, such as the Netherlands, as well as Brussels officials and trade experts, Arthur Beesley, ‘Macron and allies head for EU clash on foreign takeovers’ *Financial Times* (15 June 2017) <<https://www.ft.com/content/73aad3a-5118-11e7-bfb8-997009366969>> accessed 28 August 2017. In July, the German government has approved a measure to make it easier for the state to veto takeovers of certain firms by foreign investors to protect the country’s technical ‘know-how’, Melanie Hall, ‘Germany moves to block takeovers by foreign investors’ *Telegraph* (12 July 2017) <<http://www.telegraph.co.uk/business/2017/07/12/germany-moves-block-takeovers-foreign-investors/>> accessed 28 August 2017.

flexible and vague legal test.<sup>201</sup> As a result, foreign SOEs would face a very uncertain and unpredictable review when making an investment in certain countries. Furthermore, a foreign investment review that lacks transparency and predictability would provide leeway for investment protectionism. On the one hand, while many countries allow foreign investors to contest security-related review decisions, including administrative or judicial reviews, appeal processes are seldom used by foreign investors, and it is unlikely that national courts would override any review decision based solely on its merits.<sup>202</sup>

On the other hand, as the concept of ‘national security’ is vague and subject to expansion, it has become increasingly difficult to distinguish whether the relevant review decision is based on national security or other national interests, or on matters relating to protectionism. For example, Berlin’s withdrawal of a clearance certificate to the Aixtron deal has been characterised as an ‘emerging push for protectionism’ in Germany against Chinese companies.<sup>203</sup> Importantly, it is questionable whether and to what extent such foreign state ownership threatens national security. At least to date, there is little economic evidence to indicate that the nationality of a foreign investor - or whether or not the foreign investor is a private entity or an entity owned or controlled by a foreign government - has a measurable impact either on the market performance of the firm or on the US economy.<sup>204</sup> For most economists, the distinction between domestic- and foreign-owned firms, whether the foreign firms are privately owned or controlled by a foreign government, is sufficiently small that they would argue that it does not warrant placing restrictions on the influx of foreign investments.<sup>205</sup> Meanwhile, restricting or discriminating against SOE investments or investments from certain countries for national security reasons may discourage SOE investors and other foreign investors to invest in the host market. For example, after Australia blocked China’s SOE from taking a \$7.6bn controlling stake in an electricity distribution network on national security grounds, a spokesman for

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<sup>201</sup> Du (n 77) 138.

<sup>202</sup> See the *Rall* case mentioned earlier. Wehrlé and Pohl (n 183) 40–2.

<sup>203</sup> Kynge (n 188).

<sup>204</sup> Jackson (n 6) 39.

<sup>205</sup> *ibid.*

MOFCOM, Shen Danyang, said the ruling was protectionist and would ‘seriously’ reduce the appetite of Chinese companies to invest in Australia.<sup>206</sup>

### 3.3 Admission Provisions in Investment Treaties: Removing Barriers for SOE Investments?

As mentioned above, host states may take various measures to restrict the admission of foreign SOEs, and it is a sovereign right for states to regulate such admission. Meanwhile, international investment treaties may also affect the admission of foreign investment.<sup>207</sup> For instance, some countries may decide to accept international obligations to guarantee access for foreign investors to their territory.<sup>208</sup> As a result, host states’ measures in respect of the entry of foreign SOEs, such as national security reviews or prior approval by the local government, are potentially unlawful under the applicable investment treaty if contracting states commit to admission rights for foreign investors. Accordingly, an international investment treaty may provide admission rights to foreign SOEs, while preventing the host state from discriminating against foreign investors on the basis of their ownership. This section will thus explore investment treaty practice on market access and discuss the implications for the admission of foreign SOEs.

#### 3.3.1 Traditional Admission Clause: In Accordance with Host State Legislations

From the perspective of international law, states are in no way compelled to admit foreign investments.<sup>209</sup> Accordingly, states retain discretion to decide whether or not to grant foreign investors a right of admission. However, treaty practice in this respect reveals distinct approaches. The vast majority of BITs, especially those concluded by European countries, do not grant a right of admission but limit themselves to standards and guarantees for those investments which the host state has unilaterally decided to admit.<sup>210</sup> Typical provision of this type reads that, ‘[e]ach

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<sup>206</sup> Kynge (n 188).

<sup>207</sup> Salacuse (n 1) 218.

<sup>208</sup> Muchlinski (n 125) 177–8.

<sup>209</sup> Dlozer and Schreuer (n 3) 88.

<sup>210</sup> *ibid* 89; Salacuse (n 1) 218.

Contracting State shall in its territory promote as far as possible investments by investors of the other Contracting State and admit such investments in accordance with its legislation'.<sup>211</sup>

Under such an admission clause, host states are allowed to retain control over the access of foreign capital; to screen investments to ensure their compatibility with the state's national security, economic development, and public policy goals; and to determine the condition under which foreign investment will be permitted, if at all.<sup>212</sup>

In other words, host states are free to restrict or prohibit the entry of a foreign SOE subject to its laws and legislations. Moreover, in respect of admission conditions, the host state is under no obligation to grant foreign SOEs the same treatment that it grants to its own nationals or investors of third parties, regardless of public or private ownership. Accordingly, if a contracting state only admits foreign investments in accordance with local laws, any requirements under the domestic legal regime for foreign SOEs, such as foreign investment reviews or restrictions on industrial sectors, must be met, even if the state creates additional barriers to foreign SOEs. Also, the host states retain the freedom to revise its laws on admission and to create new barriers to foreign SOEs after the investment treaty has entered into force.<sup>213</sup>

As discussed in Chapter 2, some treaties stipulate 'in accordance with laws and regulations' in the definition of 'investment'.<sup>214</sup> Nonetheless, it is necessary to address here that if a treaty stipulates 'in accordance with local law' only in the admission clause, the SOE investor may still invoke an investment arbitration. Furthermore, its post-establishment breach of local laws does not affect the tribunal's jurisdiction, although the tribunal may deny substantial protections to the SOE investment.

Whenever the requirement of 'in accordance with host state laws' appears in a treaty, it can be understood that both the SOE investor and its investment are subject to

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<sup>211</sup> See e.g., Article 2 (1) of the Germany Model BIT (2005).

<sup>212</sup> Salacuse (n 1) 219.

<sup>213</sup> *ibid*; Dlozer and Schreuer (n 3) 89.

<sup>214</sup> See e.g., Article 1 (1) of the Albania-China BIT (1993) provides that, '[t]he term investment means every kind of asset invested by investors of one contracting state in accordance with the laws and regulations of the other contracting state in the territory of the latter'.



domestic regulations. Accordingly, if a foreign SOE fails to get approval from the host state before establishing an investment, or does not pass the foreign investment review, it shall not be granted substantial guarantees contained in the relevant treaty. Conversely, if an SOE investor meets with the host state regulations, it shall be accorded the relevant guarantees, such as non-discrimination treatment and fair and equitable treatment, as included in the treaty. Nevertheless, such guarantees only apply to the post-establishment phase under the traditional admission clause.

Thus, under a traditional admission clause, the treaty does not remove obstacles to the admission of foreign SOEs; instead, it recognises that the host government retains unlimited discretion to restrict or block a foreign SOE' entry into its territory, or to create extra requirements for foreign SOEs in respect of admission. As a result, many countries take measures against foreign SOEs to restrict admission because such restrictive measures are not subject to the post-establishment investment treaties.

### 3.3.2 US Approach of Admission Clause: Pre-establishment Non-discriminatory Treatment

The US, followed by Canada and Japan, has adopted a different approach to regulating the admission of foreign investment in their treaties. These treaties grant foreign investors the right of admission, typically based on NT and MFN. For example, the 2012 US Model BIT stipulates that:

#### *Article 3: National Treatment*

Each Party shall accord to investors of the other Party treatment no less favorable than that it accords, in like circumstances, to its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments in its territory.

#### *Article 4: Most-Favored-Nation Treatment*

Each Party shall accord to investors of the other Party treatment no less favorable than that it accords, in like circumstances, to investors of any non-Party with respect to the establishment, acquisition, expansion, management,

conduct, operation, and sale or other disposition of investments in its territory.<sup>215</sup>

Accordingly, the host state shall, theoretically, treat foreign investors at least as favourably as it treats domestic investors or third-party investors at both pre-establishment and post-establishment stages, regardless of state ownership. Consequently, if not provided for otherwise, restrictive measures by host governments over the entry of foreign SOEs may constitute a breach of NT or MFN or both.<sup>216</sup> Moreover, the US 2012 Model BIT goes beyond the Agreement on Trade-Related Investment Measures (TRIMs) on performance requirement which bans technology transfer and other localisation requirements designed to benefit local investors.<sup>217</sup> The ban on performance requirements could remove barriers relating to localisation requirements for foreign investors, regardless of whether they are publicly or privately owned, in connection to admission, acquisition and expansion.

The ECT adopts a unique approach which recognises the possibility of non-discriminatory treatment on admission but does not oblige contracting parties to grant this treatment to potential investors.<sup>218</sup> Article 10 of the ECT provides that:

(2) Each Contracting Party shall *endeavour* to accord to Investors of other Contracting Parties, as regards the Making of Investments in its Area, the Treatment described in paragraph (3).

(3) For the purposes of this Article, ‘treatment’ means treatment accorded by a Contracting Party which is no less favourable than that which it accords to its own Investors or to Investors of any other Contracting Party or any third state, whichever is *the most favourable*.<sup>219</sup> (emphasis added)

Accordingly, while contracting parties shall use their best effort to grant non-discrimination treatment, i.e., the most favourable treatment, to investors making investments, such a commitment is not legally binding at the pre-establishment

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<sup>215</sup> US 2012 Model BIT, Article 3 and Article 4. Similar provisions also see e.g., ASEAN Comprehensive Investment Agreement, Article 5 and 6; NAFTA, Article 1102 and 1103; etc.

<sup>216</sup> For more discussion on non-discriminatory treatment of foreign SOE investments see Ch 4.

<sup>217</sup> US 2012 Model BIT, Article 8 (Performance Requirements). Similar provisions see NAFTA, Article 1106.

<sup>218</sup> Salacuse (n 1) 224.

<sup>219</sup> Article 10 (4) of the Energy Charter Treaty.

stage.<sup>220</sup> Nevertheless, any contracting parties of the ECT are allowed to conclude a supplementary treaty to commit non-discriminatory treatment upon admission (Article 10 (4)). In addition, each contracting party shall endeavour (1) to limit the minimum exceptions to the non-discriminatory treatment (Article 10(5) (a)); (2) to progressively remove existing restrictions affecting investors making investments (Article 10 (5) (b)); and may (3) at any time declare voluntarily its intention not to introduce new exceptions to the non-discriminatory treatment on making of investments (Article (6) (a)). While these provisions attempt to remove restrictions on the entry of foreign investments on a ‘soft’ commitment, they are not ordinarily found in other treaties.<sup>221</sup>

Some argue that countries may find it is easier to grant MFN than NT upon admission since they may wish to give special preference to national investors to strengthen national enterprises in particular sectors or because they believe domestic investors cannot compete on an equal footing with foreign firms.<sup>222</sup> In other words, a pre-establishment MFN commitment may be designated to retain the state’s discretion on market access even if the host state does not discriminate against foreign SOEs in comparison with other foreign investors. The China-Korea BIT, for example, provides that each contracting party shall accord to investors of the other contracting party and their investments the MFN treatment, ‘including the admission of investment’.<sup>223</sup> Under this context, the Korean government shall not discriminate against a Chinese SOE investment in the foreign investment screening, but it is still allowed to prohibit the Chinese SOE from accessing critical industries or strategic sectors. Nevertheless, if Korea has approved a foreign investment in a certain sector, it cannot block a Chinese SOE investor from accessing the same sector. Therefore, a host state may also be reluctant to extend the MFN commitment to the pre-establishment phase, as that may make it possible for foreign SOEs to obtain market access. Also, contracting states should be cautious when initiating stricter screening procedures for SOE investors if they have committed to pre-establishment MFN

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<sup>220</sup> Ignacio Gómez-palacio and Peter Muchlinski, ‘Admission and Establishment’ in Peter Muchlinski, Federico Ortino and Christoph Schreuer (eds), *The Oxford Handbook of International Investment Law* (OUP 2008).

<sup>221</sup> Salacuse (n 1) 224.

<sup>222</sup> *ibid* 223.

<sup>223</sup> Article 3 (3) of the China- Korea BIT (2007).

clauses in investment treaties. A lower threshold of review or a mandatory 45-day national security investigation may impose a discriminatory treatment on the entry condition of SOE investors from the contracting party, compared to that of a private investor from a third party.

As noted, the purpose of pre-establishment non-discriminatory treatment clauses is to equalise competition conditions for market entry among potential investors, regardless of public or private ownership.<sup>224</sup> Consequently, a pre-establishment investment treaty would eliminate barriers to market access since all investors are subject to the same treatment on market access unless indicated otherwise. This is true whether or not they are domestic - or foreign-owned firms and whether or not the foreign firms are privately owned or owned by a foreign government. Therefore, a pre-establishment treaty would level the playing field between domestic and foreign investments, whether or not they are publicly- or privately- owned, and would prohibit host states from imposing at the admission stage discriminatory measures for foreign SOEs.

In practice, however, no state would necessarily wish to grant an unlimited right of admission to foreign investors, especially when they are backed by home governments. For one thing, host states may wish to exclude projects that entail the control of critical infrastructure or strategic sectors for national security or national interest considerations. For another, some countries fear that foreign SOEs may distort market competition as they are backed by home governments. In such cases, host states may not wish to grant NT (and MFN) for foreign SOEs prior to admission. To avoid a breach of international obligation, some states adopt a 'positive list' to identify sectors that are open to the investors of the other party; while some states adopt a 'negative list' to identify certain sectors that are closed.<sup>225</sup> Moreover, many treaties provide exception clauses, including general exceptions and specific exceptions, to exempt states from international obligations.<sup>226</sup> Accordingly, host states can use a positive or negative list to restrict access for foreign SOEs in certain

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<sup>224</sup> Salacuse (n 1) 222.

<sup>225</sup> Dlozer and Schreuer (n 3) 89.

<sup>226</sup> For more discussion see Ch 4 and Ch 5.

sectors or exclude the applicability of non-discriminatory obligations to certain matters or in exceptional conditions.<sup>227</sup> The exception to non-discriminatory treatment for foreign SOEs will be discussed in the next chapter.

In addition, pre-establishment non-discriminatory commitments in investment treaties do not prevent or prohibit host governments from controlling the admission of foreign SOEs to host state markets. For instance, some treaties explicitly allow host governments to take restrictive measures for essential security interests or other public policy, such as Article 18 of the 2012 US Model BIT<sup>228</sup> and Article 10 of the 2004 Canada Model FIPA,<sup>229</sup> where restrictions on admission for foreign SOEs might be justifiable on the grounds of national security or other national interest considerations.<sup>230</sup> Furthermore, some treaties guarantee the policy discretion of Contracting Parties to screen foreign investments and exclude the applicability of ISDS for government decisions following the review. For example, the China-Canada FIPA provides that ‘a decision by Canada following a review under the Investment Canada Act’ and ‘a decision by China following a review under the Laws, Regulations and Rules relating to the regulation of foreign investment’ shall not be subject to the dispute settlement provisions.<sup>231</sup> Under the China-Australia FTA, Australia reserves its right to screen all direct investments, new business proposals

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<sup>227</sup> For example, Article 16 of the Canada-Kuwait BIT (2011) provides that NT and MFN shall not apply to: 1) non-conforming measures; 2) any measures that a Party adopts or maintains with respect to sectors, subsectors or activities set out in Annex 1 (Reservations for Future Measures); 3) intellectual property rights in consistent with WTO; 4) procurement by a Party; 5) subsidies or grants provided by a Party, including government-supported loans, guarantees and insurance.

<sup>228</sup> Article 18 (2) of the 2012 US Model BIT provides that, ‘[n]othing in this Treaty shall be construed... to preclude a Party from applying measures that it considers necessary for the fulfillment of its obligations with respect to the maintenance or restoration of international peace or security, or the protection of its own essential security interests’.

<sup>229</sup> Article 10 (1) of the 2004 Canada Model FIPA provides that, ‘[n]othing in this Agreement shall be construed to prevent a Party from adopting or enforcing measures necessary: (a) to protect human, animal or plant life or health; (b) to ensure compliance with laws and regulations that are not inconsistent with the provisions of this Agreement; or (c) for the conservation of living or non-living exhaustible natural resources’.

<sup>230</sup> For more discussion see Ch 5.

<sup>231</sup> Annex D. 34 of the China-Canada FIPA (2012). Similarly, Article 9.11 (4) of the China-Australia FTA provides that, ‘[m]easures of a Party that are non-discriminatory and for the legitimate public welfare objectives of public health, safety, the environment, public moral or public order shall not be the subject of a claim under the investor-State dispute settlement’.

and acquisitions of interests in land by Chinese SOEs, regardless of transaction size.<sup>232</sup>

Nevertheless, if an investment treaty does not explicitly provide exceptions and reservations, any measure restricting a foreign SOE's admission may constitute a violation of pre-establishment non-discrimination commitments and is likely to be subject to closer scrutiny by international tribunals.

### 3.3.3 Recent Practice: Towards Pre-establishment Protections for Foreign SOEs?

While most investment treaties do not include admission provisions or only admit foreign investments in accordance with host states laws and legislation, recent years have witnessed some countries' ambitions to expand market access by adopting pre-establishment non-discriminatory treatments in investment treaty negotiations.

The EU, in particular, has explicitly committed to market access and performance requirements in the CETA with Canada, and has accepted a pre-establishment national treatment obligation on the basis of a 'negative list' of sectors that remain subject to tighter controls.<sup>233</sup> Accordingly, both the EU and Canada has significantly expanded market access for foreign investments, regardless of whether they are publicly or privately owned; and the host state cannot take restrictive measure on admission except for sectors explicitly listed in Annex I and Annex II. Moreover, through Annex I, both EU and Canadian businesses, regardless of whether ownership is public or private, will benefit from any future liberalisation if the measures are relaxed or eliminated vis-à-vis third country investors in the future. Also, Canada agreed to liberalisation in some key sectors such as postal services, telecoms and maritime transport without transition periods, while the EU guaranteed to Canadian investors its current level of liberalisation in areas like mining, certain services related to energy, environmental services and certain professional

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<sup>232</sup> China-Australia FTA (2015), Annex III: Investment and Services Schedules of Australia and China.

<sup>233</sup> Comprehensive economic and trade agreement (CETA) between the EU and Canada (2014), Article 8.4 (Market access), Article 8.5 (Performance requirements), Article 8.6 (National treatment), Article 8.7 (Most-favoured-nation treatment), Article 8.8 (Senior management and boards of directors), Annex I and Annex II.

services.<sup>234</sup> Besides, both the EU and Canada have taken on obligations on performance requirements that prohibit technology transfer and other localisation requirements.<sup>235</sup>

However, it is hard to say that SOE investors can benefit from such market access. The CETA explicitly allows the Canadian government to screen acquisitions of Canadian companies by EU investors for both ‘net benefit’ and national security, and to apply a lower threshold for review of EU investors that constitute SOEs.<sup>236</sup> Also, the CETA safeguards the flexibility of the EU and member states to introduce discriminatory measures or quantitative restrictions in the future by specifying certain areas or sectors in the reservations of Annex II. These include, among others, public monopolies and exclusive rights for public utilities and public services such as education, health, social services and water supply where the EU and member states have no obligation to privatise any of these sectors under the CETA.<sup>237</sup> As a result, the Canadian government retains discretion to prevent and block an EU investment involving SOEs in a foreign investment review. Further, the EU and member states can maintain restrictive measures or take new measures to restrict or exclude foreign control of certain sectors, whether they are state-owned or not.

Nevertheless, the CETA indicates that the EU has started filling the gap in ‘entry’ or ‘admission’ through both multilateral and bilateral agreements at the EU level covering investment market access and investment liberalisation, notably by ensuring non-discriminatory treatment upon entry of investors from a third country, and vice versa.<sup>238</sup> The EU is currently negotiating stand-alone investment agreements or FTAs (including investment chapters) with China, Myanmar, India, Singapore, Japan, the US, Egypt, Tunisia, Morocco, Jordan, Malaysia and Vietnam, which are likely to adopt the same approach to improve market access by granting pre-establishment national treatment on the basis of certain reservations listed in the

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<sup>234</sup> European Commission (EC), ‘CETA – Summary of the final negotiating results’ (February 2016) <[http://trade.ec.europa.eu/doclib/docs/2014/december/tradoc\\_152982.pdf](http://trade.ec.europa.eu/doclib/docs/2014/december/tradoc_152982.pdf)> accessed 12 September 2017.

<sup>235</sup> Article 8.5 of the CETA.

<sup>236</sup> EC, ‘CETA – Summary of the final negotiating results’ (n 234) 10.

<sup>237</sup> *ibid.*

<sup>238</sup> Commission (EC), ‘Towards a Comprehensive European International Investment Policy’ COM (2010) 343 final (Brussels, 7 July 2010) 5.

Annexes.<sup>239</sup> Accordingly, the EU is removing barriers to market access for foreign investors from third countries, but member states still retain discretion to restrict or prohibit market access for foreign investors in certain sectors. These include critical infrastructure or, under certain conditions, national security or the maintenance of public order. In this context, the ‘negative list’ is of great significance to foreign SOE investors since it explicitly provides reservations on market access commitments, including whether the contracting states reserve the right to adopt new or restrictive measures in the future. Although such a list may restrict admission for SOE investors, it clarifies the protection commitments and reserved measures or sectors, which could in turn improve the stability and transparency of the domestic framework of foreign investments. Therefore, if a treaty that applies for both pre-establishment and post-establishment phases does not explicitly include such reservations, any restrictions on the admission for foreign SOEs by the contracting state may constitute a violation of international obligations.

Perhaps the most remarkable practice on foreign investment admission is the on-going Chinese BIT talks with the US and the EU. As stated by some government officials and academic scholars, the US-China BIT is an opportunity to expand market access reciprocity for investors.<sup>240</sup> In 2013, Chinese government committed to negotiating a BIT with the US government that will accept pre-establishment national treatment obligation on the basis of a ‘negative list’ approach of reserved sectors and industries.<sup>241</sup> To date, the negotiating parties have changed negative lists three times.<sup>242</sup> Likewise, in the context of the China-EU BIT talks, the EU Trade Commissioner De Gucht has made clear that ‘the EU-China investment agreement is not about investment protection only, but also about market access for European companies’.<sup>243</sup> The European Parliament has likewise emphasised that the China-EU

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<sup>239</sup> For example, the Agreed text of the EU-Vietnam FTA of January 2016, Chapter 8: Trade in Services, Investment and E-Commerce, Article 2- Article 6, see [http://trade.ec.europa.eu/doclib/docs/2016/february/tradoc\\_154210.pdf](http://trade.ec.europa.eu/doclib/docs/2016/february/tradoc_154210.pdf) accessed 21 March 2017.

<sup>240</sup> Gloudeman and Salidjanova (n 168) 3; Chow (n 30) 121.

<sup>241</sup> MOFCOM, ‘MOFCOM Spokesman Shen Danyang Comments on China and US to Promote Energetically Negotiations on Bilateral Investment Agreement’ (16 July 2013) <http://english.mofcom.gov.cn/article/newsrelease/policyreleasing/201307/20130700200566.shtml> accessed 21 March 2017.

<sup>242</sup> Gloudeman and Salidjanova (n 168) 13.

<sup>243</sup> European Commission, ‘Investment deal with China: “only under the condition that market access for



BIT negotiations would be opened only on condition that China has given formal approval for market access.<sup>244</sup> To date, the two sides have engaged in twelve rounds of negotiations and reached clear conclusions on an ambitious and comprehensive scope for the EU-China investment agreement.<sup>245</sup> Although the final texts of both BITs remain to be seen, it is clear that both the US and the EU expect to increase market access for their businesses in China through a pre-establishment national treatment provision and *versa vice*.<sup>246</sup>

China's regulatory approach to foreign investment admission has been criticised as opaque and restrictive (Figure 3.2). In particular, some scholars argue that China's reluctance to include liberal national treatment and investor-state arbitration provisions in its earlier BITs likely stemmed from its preference to retain sovereignty to screen and regulate FDI and to discriminate against foreign investors in favour of domestic industries and companies, especially but not exclusively SOEs.<sup>247</sup> Hence, China has never granted pre-establishment national treatment and MFN to investors in its past BITs. Even in the recent China-Canada FIPA, China only committed to extending national treatment to the expansion of investment in sectors 'not subject to a prior approval process' under the relevant sectoral guidelines and applicable legislation.<sup>248</sup> Hence, if the Chinese BITs with the US or the EU could agree to a pre-establishment national treatment on a negative list, it will become a symbol of the emerging new generation of BIT practice, or the 'Global BIT 2.0'.<sup>249</sup> Accordingly, all investors from the US or the EU would enjoy market access equal to that afforded to Chinese firms, including Chinese SOEs, unless explicitly excluded by the negative lists. Furthermore, given that China has committed to pre-establishment MFN

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European companies is granted"" (Brussels, 18 October 2013)

<<http://trade.ec.europa.eu/doclib/press/index.cfm?id=976>> accessed 12 September 2017.

<sup>244</sup> European Parliament resolution of 9 October 2013 on the EU-China negotiations for a bilateral investment agreement (2013/2674(RSP)) [2016] OJ C181/4.

<sup>245</sup> MOFCOM, 'The Twelfth Round Negotiation on China-EU BIT Held in Brussels' (26 September 2016)

<<http://www.mofcom.gov.cn/article/ae/ai/201609/20160901400998.shtml>> accessed 21 March 2017.

<sup>246</sup> Commission (EC), 'Impact Assessment Report on the EU-China Investment Relations' SWD (2013) 185 final (Brussels, 23 May 2013) 16; Gloudeman and Salidjanova (n 168) 12.

<sup>247</sup> Axel Berger, 'China's New Bilateral Investment Treaty Programme: Substance, Rational and Implications for International Investment Law Making' (2008) 9

<[https://www.die-gdi.de/uploads/media/Berger\\_ChineseBITs.pdf](https://www.die-gdi.de/uploads/media/Berger_ChineseBITs.pdf)> accessed 12 September 2017.

<sup>248</sup> Article 6 of the China-Canada FIPA (2012).

<sup>249</sup> Shan and Wang 260.

treatment in the Canadian BIT and the Australian FTA,<sup>250</sup> investors from Canada and Australia may also benefit from treatment equal to what China accords to its domestic firms, including SOEs, unless explicitly excluded in the treaties.<sup>251</sup>

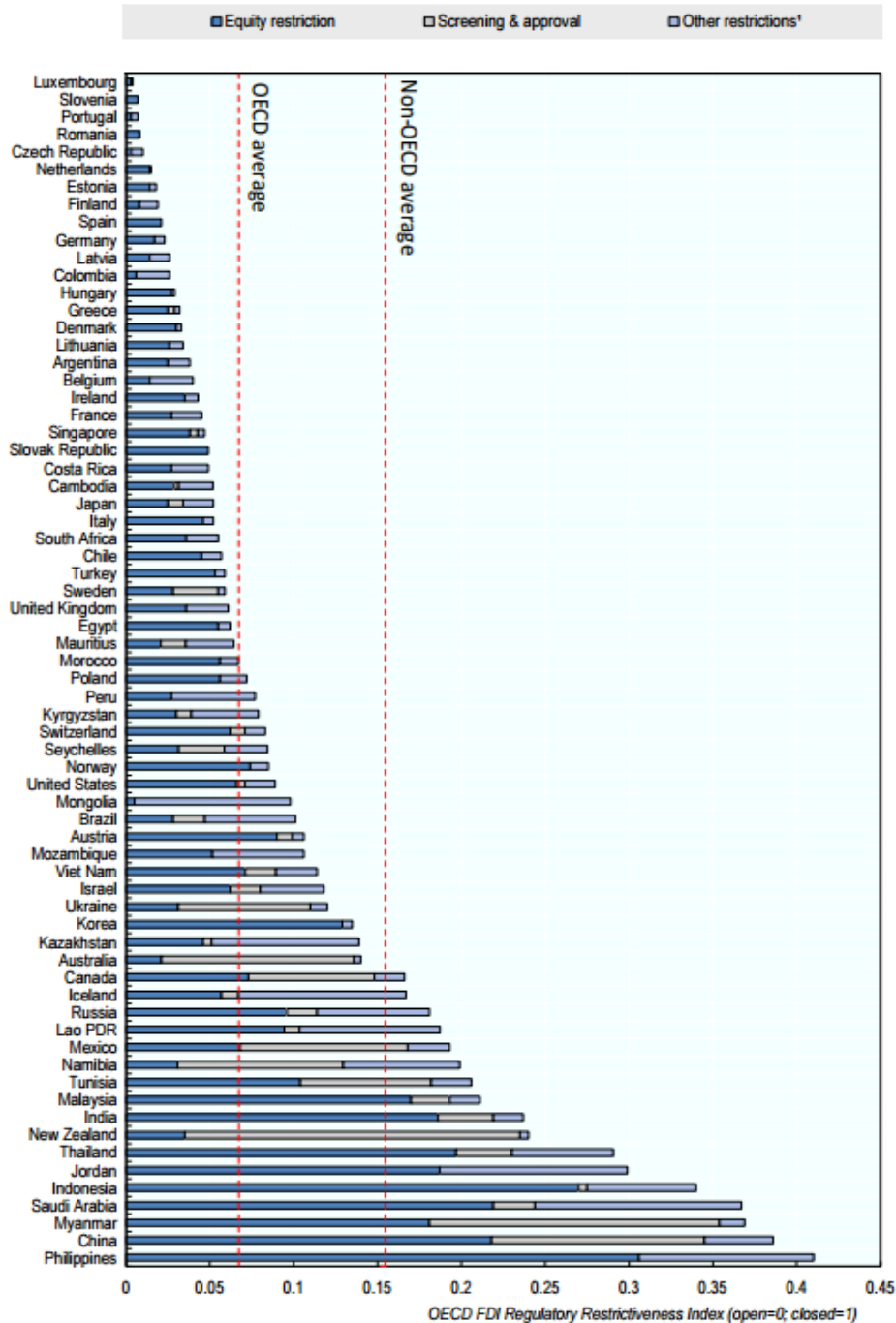


Figure 3.2 FDI regulatory restrictiveness in selective countries, 2015

Source: OECD FDI Regulatory Restrictive Index database

<<http://www.oecd.org/investment/fdiindex.htm>>

<sup>250</sup> Article 5 of the China-Canada FIPA; Article 9.4 of the China-Australia FTA.

<sup>251</sup> See also Ch 4.

To a great extent, the degree of market access depends on the length of negative list. As mentioned earlier, while China has cut the restrictive measures and categories in the new negative list for FTZs, both the US and the EU wish China to shorten the list as much as possible to obtain more market access.<sup>252</sup> The US Trade Representative said that China's latest offer in bilateral investment talks was a 'serious effort', but still 'a fair distance away from being accepted'.<sup>253</sup> Likewise, the European Chamber welcomed the reduction of the negative list in Chinese pilot FTZs, but also proposed further elimination of the remaining barriers and speedy roll-out access on a nationwide basis for the service sector.<sup>254</sup> It is unclear whether the lists in FTZs and the Draft Law will be replicated in China's BIT negative list. But, the preparations and negotiations for the negative list are likely to take a significant amount of time, since the contracting parties have to assess whether and to what extent each sector and industry is internationally competitive and should be opened up to international investors.<sup>255</sup> The laborious task in China might involve taking stock of non-conforming measures at both the central level and the local level while, for the EU, market access commitment might affect both the EU level and member state level, with the latter then being further divided into central government and local levels.<sup>256</sup> Working out solutions to such challenging and complex issues requires not only a tremendous amount of time but also intelligence and perhaps innovations.<sup>257</sup>

Some scholars consider that Chinese investors, especially SOEs, would be the major beneficiaries from pre-establishment protections in potential BITs, and they raise concerns about the reciprocity of market access and the efficiency of a high standard BIT.<sup>258</sup> However, it is questionable if Chinese investors, especially SOEs, could truly

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<sup>252</sup> To date, no official has publicly commented on China's negative list.

<sup>253</sup> David Lawder, 'U.S. trade chief says China offer falls short, UK could join TPP' *Reuters* (6 Jul 2016) <<http://www.reuters.com/article/us-usa-china-trade-idUSKCN0ZM2JE>> accessed 21 March 2017.

<sup>254</sup> The European Union Chamber of Commerce in China, 'China Free Trade Zone 2015 Update: European Chamber Initial Assessment' (22 April 2015) <[http://www.europeanchamber.com.cn/en/national-news/2269/china\\_free\\_trade\\_zones\\_2015\\_update\\_european\\_chamber\\_initial\\_assessment](http://www.europeanchamber.com.cn/en/national-news/2269/china_free_trade_zones_2015_update_european_chamber_initial_assessment)> accessed 21 March 2017.

<sup>255</sup> Wenhua Shan and Sheng Zhang, 'The Potential EU-China BIT: Issues and Implications' in Marc Bungenberg, August Reinisch and Christian Tietje (eds), *EU and Investment Agreements: Open Questions and Remaining Challenges* (Hart Publishing 2013).

<sup>256</sup> Shan and Wang (n 249) 262.

<sup>257</sup> *ibid.*

<sup>258</sup> Gloudeman and Salidjanova (n 168) 23–4; Chow (n 30) 101.

benefit from increased market access because host states still retain considerable discretion to control the access of foreign investments at a national level. For example, the US regulatory regime for the FDI is relatively closed and more restrictive than in many other developed countries (Figure 3.2), especially considering that it does not permit a judicial review of the CFIUS ruling. In fact, a main concern of the Chinese government in negotiating the BIT with the US is the ambitious CFIUS review against Chinese SOEs and even all Chinese investments. Some worry that pre-establishment non-discriminatory treatment in the potential US-China BIT could enable Chinese SOEs (as major investors) to bring a claim before an international tribunal if they are displeased with a CFIUS ruling.<sup>259</sup> But, it has been also argued that the national security exception clause appears ‘broad enough’ to allow US regulators sufficient bandwidth to protect its essential security interests,<sup>260</sup> although the issue is questionable and never tested in practice. Furthermore, the ISDS mechanism under US BITs does not affect host states’ right to regulate, and it is uncertain whether the tribunal will override the CFIUS decision.<sup>261</sup> Likewise, if the potential China-EU BIT follows the CETA provisions, the EU’s negative lists may be not shorter than China’s reservations, including reservations for both EU and its member states at all levels of governments.<sup>262</sup> Furthermore, if the potential China-EU BIT follows Annex II of CETA which permits the EU and the member states not only to maintain existing discriminatory measures but also to adopt discriminatory measures in the future, Chinese investors would face much more difficulty and uncertainty when investing in Europe.<sup>263</sup> Although the legal regimes of the EU and its member states are neutral on the ownership of investments, the above reservations in negative lists could provide leeway for discriminatory treatment of Chinese SOEs.

Nevertheless, it is still necessary to note that the trend towards market access commitments in investment treaties does, to some extent, remove barriers for foreign

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<sup>259</sup> Chow (n 30) 121–3.

<sup>260</sup> *ibid* 120. For further discussion see Ch 5.

<sup>261</sup> Gludeman and Salidjanova (n 168) 20, 25.

<sup>262</sup> See Annex I and Annex II of the CETA.

<sup>263</sup> In this respect, the China-Canada FIPA seems more liberalised for foreign investments since it merely permits existing discriminatory measures but does not allow new discriminatory measures.

investments, regardless of whether they are publicly- or privately- owned.<sup>264</sup> In particular, it improves the stability and transparency of domestic legal regimes for foreign investments, in particular by reducing the ability of host states to take discriminatory measures against foreign investors in unlisted sectors, without violating relevant commitments on market access. Also, since under such treaties, international law guarantees protection of market access, it is possible for investors to challenge a host government's discriminatory measure in an international investment arbitration.<sup>265</sup> Although this challenge is debatable and untested in practice, it might, at least theoretically, restrict or prevent host government from making arbitrary and discriminatory decisions in foreign investment reviews since the use of political pressure or administrative denials could constitute a violation of the MFN or NT provisions, or both.<sup>266</sup> In addition, since China has never granted pre-establishment national treatment on the basis of negative list in its investment treaties, such a market access commitment in a BIT with the US and the EU might expand the market access for other foreign investors through MFN clauses. It might also serve as an important model for other bilateral and multilateral investment agreements, including the RCEP, the TTIP and the potential Free Trade Area of the Asia-Pacific (FTAAP).<sup>267</sup>

### 3.4 Concluding Remarks

In sum, with the rise of FDI led by SOEs, an increasing number of countries are re-evaluating, and often tightening, their oversight regimes on the admission of foreign investment. As a result, host states may use various approaches to control the entry of foreign SOEs, including restricting or excluding foreign control in critical infrastructure and strategic sectors or conducting foreign investment screenings based on national security considerations and other national interests. Our review of

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<sup>264</sup> It is necessary to state that the market access commitment in potential Chinese BITs with the EU and the US would be a comprehensive one including pre-establishment NT, MFN, performance requirement, senior management and boards of directors. But, the pre-establishment NT is of the most significance.

<sup>265</sup> As noted, it is disputable whether an adverse decision by state on market access, such as blocking a Chinese transaction in CFIUS review, could be subject to an international investment arbitration challenge, see Gloudeman and Salidjanova (n 168) 25. See also Ch 5.

<sup>266</sup> Chow (n 30) 121.

<sup>267</sup> Gloudeman and Salidjanova (n 168) 23.

domestic approaches to the screening of foreign investments shows that SOE investors are likely to face significantly different admission conditions in different countries in respect of similar or even the same economic activities. Recent developments in national security review processes in some countries indicate that SOE investors, especially those from China, are likely to be subject to closer scrutiny in the future. Given that the concept of ‘national security’ is unclear and expanding in national practice, SOE investors may face less certainty and predictability when accessing a foreign market. Also, it has become increasingly difficult to distinguish whether national regulations for SOE investors serve national security and other national interests, or serve protectionism.

In the context of international investment law, host states have unlimited discretion to decide upon access granted to foreign SOEs. Most IIAs do not provide pre-establishment obligations, or merely admit foreign investment ‘in accordance with host states’ laws and legislations’. Accordingly, such IIAs in fact allow states to restrict the admission of SOEs, rather than to remove domestic obstacles to the admission of SOEs. As a result, most treaties only cover protections for the post-establishment phase, providing leeway for states to restrict or prohibit foreign SOEs’ market access, which may leave room for investment protectionism.

However, the US investment treaties typically grant market access commitments especially including a pre-establishment national treatment provision on the basis of a ‘negative list’. Accordingly, foreign investors, whether publicly- or privately-owned, shall be subject to equal conditions upon admission as that for domestic investors including domestic SOEs, unless explicitly provided otherwise. As a result, this treaty practice could remove barriers to market access for foreign investors since a host state might violate international obligations if it restricts or discriminates against foreign investors in relation to market access. Considering that other major economies such as China, the EU, Canada, Japan and India are also moving toward extending treaty protections to the pre-establishment phase, it can be argued that the

world is moving toward an era of ‘Global BIT 2.0’, that is, a new generation of BITs that combines investment protection with investment liberalisation.<sup>268</sup>

The national and international practice on the admission of foreign SOEs confirms two divergent trends in investment policy and law regime in recent years.<sup>269</sup> At the national level, while some countries have liberalised entry conditions for foreign investors in a variety of industries, an increasing number of restrictions or regulations are being introduced to control the admission of foreign investors, including SOEs, for national security, strategic industries and competitiveness reasons.<sup>270</sup> At the international level, new generation IIAs embrace investment liberalisation by providing pre-establishment protections for foreign investors and promoting investment liberalisation. Many reasons may contribute to such a disparity between national and international trends. On the one hand, with the development of economic globalisation, both developing and developed countries wish their firms to enjoy improved market access on the basis of pre-establishment national treatment in foreign markets. But on the other hand, economic globalisation is not perfect and host states wish to preserve certain regulatory space to prevent potential risks. In addition, the disparity between national and international practice in respect of admission confirms that the investment regime has become more complex and divergent.

These trends have different implications for SOE investors and states. For SOE investors, they may have to face tougher screening or protectionist measures by host states at the national level. But internationally, the emerging trend of including pre-establishment protections may be helpful for SOE investors, as it extends the scope of protections and permits investors to bring claims before international arbitral tribunals if the host state takes any restrictive measures against them in relation to admission. In 2007, a Singaporean SOE, Temasek, considered international arbitration procedures after exhausting local procedures in Indonesia where the Indonesian antitrust authorities required Temasek to sell its stakes in the two largest

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<sup>268</sup> Wenhua Shan and Sheng Zhang, ‘Market Access Provisions in the Potential EU Model BIT: Toward a “Global BIT 2.0”?’ (2014) 15 *The Journal of World Investment & Trade* 422, 453.

<sup>269</sup> See also Ch 1.

<sup>270</sup> UNCTAD, *World Investment Report 2017- Investment and Digital Economy* xi.

mobile phone operators.<sup>271</sup> Although this case concerns neither admission nor establishment of investment, and the company eventually did not submit an international arbitration claim against Indonesia,<sup>272</sup> it at least has indicated a possibility of the international arbitration option. As argued by some scholars, with the worldwide increase in sovereign investments and a growth in national protectionist measures against SOE investments, SOE investors may increasingly use international investment arbitration to seek protection in the future.<sup>273</sup>

Nevertheless, it remains to be seen whether and to what extent foreign SOEs can benefit from the pre-establishment protection. On the one hand, states may use negative lists to reserve restrictive measures or exclude foreign ownerships in certain sectors; on the other hand, states may exempt SOEs from pre-establishment obligations by invoking general or specific exceptions specified in the treaty. Also, it is questionable whether a breach of pre-establishment commitment by host states, such as an adverse decision in a CFIUS review, would be subject to international investment arbitration.<sup>274</sup> As a result, host states may still retain considerable discretion to control the admission of foreign SOEs.

Undoubtedly, increased market access reciprocity will benefit investors from both contracting parties. Also, there is strong evidence that liberal admission rules promote bilateral foreign investments.<sup>275</sup> Therefore, states should promote the opening of domestic sectors to foreign investments, instead of taking restrictive measures for protectionist ends. Meanwhile, it is necessary for states to evaluate the

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<sup>271</sup> John Aglionby, 'Indonesian watchdog targets Temasek' *Financial Times* (20 November 2007)

<[http://www.ft.com/cms/s/0/2d8a5c84-970b-11dc-b2da-](http://www.ft.com/cms/s/0/2d8a5c84-970b-11dc-b2da-0000779fd2ac.html?ft_site=falcon&desktop=true#axzz4c6E130jK)

0000779fd2ac.html?ft\_site=falcon&desktop=true#axzz4c6E130jK> accessed 22 March 2017; Nicole

McCormick, 'Temasek loses appeal on Indon price fixing claims' *Telecom Asia. Net* (25 May 2010)

<<http://www.telecomasia.net/content/temasek-loses-appeal-indon-price-fixing-claims>> accessed 22 March 2017.

<sup>272</sup> Janeman Latul and Saeed Azhar, 'Temasek to pay Indonesia fines after failed anti-monopoly appeal' *Reuters* (Jakarta, 18 Jan 2011) <<http://www.reuters.com/article/indonesia-temasek-idUSL3E7CI0AJ20110118>> accessed 22 March 2017. Some scholars argue that this is because the Singapore-Indonesia BIT (2006) does not explicitly recognise Temasek as 'investor', see Chaisse and Sejko 88. See also Ch 2.

<sup>273</sup> Burgstaller 177.

<sup>274</sup> As mentioned earlier, CETA provides only claims arising out of host state's breach of the chapter on investment protection may be subject to investor-state dispute resolution mechanism. But similar provisions are not provided in other treaties.

<sup>275</sup> Axel Berger and others, 'Do Trade and Investment Agreements Lead to More FDI? Accounting for Key Provisions Inside the Black Box' (2013) 10 *International Economics and Economic Policy* 247.



international competitiveness of each domestic sector and industry and be cautious in designing a negative list to reduce risks of breaching international obligations.

Notwithstanding, host states' regulations on foreign SOE investments should strike an proper balance between promoting and protecting SOE investments and addressing host states' right to regulate SOE concerns on national security risks and competition distortions. In this process, host states' measures will affect foreign SOE investment at both pre-establishment and post-establishment stages. As most treaties provide substantive protections for post-establishment phase, host states' restrictive measures are likely to violate relevant obligations and be scrutinised in international arbitrations. Next chapter will discuss these issues in detail.



## CHAPTER 4:

# TREATMENT STANDARDS OF SOE INVESTMENTS

### 4.1 Introduction

This chapter focuses on the substantive protections to SOE investments under international investment treaties. While treaties differ, almost all provide substantive protections for investors against discrimination and uncompensated expropriation in host states.<sup>1</sup> Furthermore, numerous treaties also require host states to guarantee certain standards of treatment to foreign investors and investments through fair and equitable treatment (FET), umbrella clauses, full protection and security, etc. If a host state breaches its commitments on obligations of substantive protections to foreign investors, the investor may file claims for monetary compensation at international tribunals. Whereas most debates centre on whether the state ownership disqualifies SOEs as protected investors, the issue of substantive protections to SOE investments seems more important since it touches upon the main body of the international investment regime.

One may then ask why SOEs, rather than any other foreign investors, are of particular interest in the substantive protections offered by IIAs, i.e., the standards of treatment. As noted in Chapter 1, SOEs are often viewed differently from private-owned enterprises due to their political nature and non-commercial motivations in activities. Therefore, some have considered that SOE investors should not be accorded the same treaty protections as that accorded to private investors since they have enjoyed preferences or competitive advantages in their home countries. Also, to address host states' concerns over SOE investments, SOE investors may be subject to greater transparency obligations or stricter screening in respect of admission. In such cases, SOEs are treated differently from other enterprises by host states, but the question is whether the SOE can challenge national rules before investment tribunals claiming the host state violates international obligations.

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<sup>1</sup> This is a main reason why developed countries designed the BIT and the investor-state arbitration mechanism at the beginning, see also Ch 1.

As noted in Chapter 2, foreign SOEs are in principle qualified for investment protections, and recent cases have indicated that SOE investors can file claims against host states at international tribunals if states fail to meet substantive protections. In this scenario, the tribunal will have to examine whether a host state's regulatory measure against the SOE violates any international obligations and may request the state to compensate the SOE investor for liability.<sup>2</sup> Since host states' conduct against SOEs are subject to substantive treatments stipulated in IIAs,<sup>3</sup> the state's right to regulate SOE investments may be restricted by its obligations on substantive protections. Furthermore, the risk of investment arbitration may also discourage states from taking measures to address their concerns over SOE investments.<sup>4</sup>

As key provisions in investment treaties, standards of treatment have long been discussed and debated by tribunals and scholars.<sup>5</sup> As will be elaborated later, since treatment provisions are often formulated broadly in vague terms, arbitral tribunals have a great degree of discretion in the interpretation and application of key treaty provisions. In addition to the uncertainty and unpredictability in arbitral practice, the unique characteristics of SOEs may generate problematic issues in the application of treatment standards under IIAs. For example, whether the state ownership plays a

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<sup>2</sup> Anne van Aaken, 'Primary and Secondary Remedies in International Investment Law and National State Liability: A Functional and Comparative View' in Stephan W Schill (ed), *International Investment Law and Comparative Public Law* (OUP 2010).

<sup>3</sup> Jeswald W Salacuse, *The Law of Investment Treaties* (Second Edi, OUP 2015) 228.

<sup>4</sup> Some scholars have argued that investment treaties may discourage state from adopting legitimate regulatory measures in practice- the concern has been named 'regulatory chill', see e.g., Christian Tietje and Freya Baetens, 'The Impact of Investor-State-Dispute Settlement (ISDS) in the Transatlantic Trade and Investment Partnership' (2014) 7 <<http://media.leidenuniv.nl/legacy/the-impact-of-investor-state-dispute-settlement-isds-in-the-ttip.pdf>> accessed 12 September 2017.

<sup>5</sup> See, for example, August Reinisch (ed), *Standards of Investment Protection* (OUP 2008); Stephan W Schill, 'Fair and Equitable Treatment, the Rule of Law, and Comparative Public Law' in Stephan W Schill (ed), *International Investment Law and Comparative Public Law* (OUP 2010); Wenhua Shan, Norah Gallagher and Sheng Zhang, 'National Treatment for Foreign Investment in China: A Changing Landscape' (2012) 27 ICSID Review 120; Jean Kalicki and Suzana Medeiros, 'Fair, Equitable and Ambiguous: What Is Fair and Equitable Treatment in International Investment Law?' (2007) 22 ICSID Review 24; Andrew Newcombe and Lluís Paradell, *Law and Practice of Investment Treaties: Standards of Treatment* (Kluwer Law International 2009); Andrew D Mitchell, David Heaton and Caroline Henckels, *Non-Discrimination and the Role of Regulatory Purpose in International Trade and Investment Law* (Edward Elgar Publishing 2016); Konrad von Moltke, 'Discrimination and Non-Discrimination in Foreign Direct Investment: Mining Issues' (2002); Nicholas DiMascio and Joost Pauwelyn, 'Nondiscrimination in Trade and Investment Treaties: Worlds Apart or Two Sides of the Same Coin?' (2008) 102 American Journal of International Law 48.

role in assessing the “in like circumstance” requirement of non-discriminatory treatment standards in some treaties, and whether SOE investors have weak legitimate expectations under fair and equitable treatment since they have used to the stricter screenings.

This chapter, therefore, discusses whether and to what extent investment treaties offer SOEs substantive protections. For the purpose of this research, the first section focuses on the ‘relative’ standards of protections, i.e., the non-discriminatory treatment of SOEs, including national treatment (NT) and most-favoured-nation treatment (MFN). The second section moves to ‘absolute’ standards of protections—especially the FET of SOEs. Each section considers both treaty practice and arbitral tribunals’ interpretations to examine how SOEs should be treated in the host state’s jurisdiction and how to strike a balance of rights and obligations between SOE investors and host states. The last section summarises the main findings and provides implications for future treaty negotiations.

## 4.2 Non-discriminatory Treatment of SOE Investors

Non-discriminatory treatment (NDT), including both NT and MFN, is a ‘relative’ standard of investment protections in IIAs, which requires host states to treat foreign investors and investments no less favourably than they treat domestic investors and investments (i.e., NT) and other foreign investors and investments (i.e., MFN).<sup>6</sup> As a core investment protection, NDT attempts to level the playing field among all economic actors with the assumption that such equality of treatment will foster competition and economic growth.<sup>7</sup> However, such equality is not easy to achieve since states may have different standpoints and interests in foreign investments. For instance, countries such as China did not provide NT in its earlier treaties.<sup>8</sup>

NDT of SOEs may be more complex and controversial. As noted in previous chapters, SOEs are often viewed differently from private investors due to state

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<sup>6</sup> Salacuse (n 3) 274.

<sup>7</sup> *ibid.*

<sup>8</sup> Gallagher and Shan, *Chinese Investment Treaties: Policies and Practice* 160.

ownership. Consequently, some may argue that treatment of foreign SOEs should not be equal to that of domestic investors as they have received many benefits from their home governments. Also, the rise of SOEs as a global investor has attracted increasing concerns including national security and competitive neutrality concerns. Regardless of whether such concerns are reasonable or not, some countries have taken or wish to take restrictive measures against foreign SOEs to respond to challenges and potential risks.<sup>9</sup> A question arises as to whether or not the different or restrictive treatment of foreign SOEs constitutes a violation of nondiscrimination commitment under investment treaties.

Indeed, while NDT has become a critical issue in investment policies and treaty practice, little research discusses the NDT of foreign SOEs under IIAs. A possible reason is that states (especially developed states) have traditionally attached more importance to protecting private investors and investments. However, the situation now has changed. SOEs from emerging economies are active investors while developed countries are worried about the negative effects of SOE investments, which may result in a different attitude towards NDT of SOEs at the international level. Hence, this section will focus on whether and to what extent NDT applies to SOE investments.

#### 4.2.1 Applying NDT to SOEs

##### *A. General rule*

Most investment treaties contain general NDT provisions that aim at maintaining a level playing field among investors, whether nationally or internationally. However, such provisions do not specifically differentiate between foreign investors of different ownership backgrounds. NT and MFN normally require host states to treat foreign investors and their investments in a way that is no less favourable than the

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<sup>9</sup> For instance, Canadian policies in respect of sovereign investments, for example, have changed concerning the treatment of foreign SOE investment in the country's Western oil sands, see A Edward Safarian, 'The Canadian Policy Response to Sovereign Direct Investment' in Karl P Sauvant, Lisa E Sachs and Wouter PF Schmit Jongbloed (eds), *Sovereign Investment: Concerns and Policy Reactions* (OUP 2012) 431–52; Angela Avery, Peter Glossop and Paula Olexiuk, 'Foreign Investment in Canada's Oil and Gas Sector: New and Emerging Challenges' (2013) 51 *Alberta Law Review* 343. See also Ch 1 and Ch 3.

treatment accorded to domestic (or third party) investors and their investments.<sup>10</sup> For instance, Article 3 of the China-Germany BIT (2003) provides:

(2) Each Contracting Party shall accord to investments and activities associated with such investments by the investors of the other Contracting Party treatment no less favourable than that accorded to the investments and associated activities by its own investors.

(3) Neither Contracting Party shall subject investments and activities associated with such investments by the investors of the other Contracting Party to treatment less favourable than that accorded to the investments and associated activities by the investors of any third State.

In this context, foreign SOEs shall be granted NT and MFN as long as they qualify as investors and their investments are covered by the treaty at issue. As noted in Chapter 2, whilst most IIAs are silent as to whether SOEs qualify as ‘investors’, there are more treaties specifically including rather than excluding them.<sup>11</sup> Hence, SOEs shall, in principle, enjoy NDT under current IIAs despite their silence on SOEs.

Notably, some earlier treaties, especially those concluded by the United States, provided that ‘each Party shall ensure that any state enterprise that it maintains or establishes accords the better of national or most favoured nation treatment in the sale of its goods or services in the Party’s territory’.<sup>12</sup> A similar provision is also included in NAFTA Article 1503 (State Enterprises).<sup>13</sup> Such provisions do not deal with SOEs as foreign ‘investors’, but domestic SOEs (of the host state) that provide goods or services to foreign investors. As such, there is no question of whether or not such SOEs should enjoy NDT, but rather whether investment treaties should guarantee NDT to foreign investors to which domestic SOEs provide goods or

<sup>10</sup> See e.g., Rudolf Dlozer and Christoph Schreuer, *Principles of International Investment Law* (Second Edi, OUP 2012) 198, 206; Gallagher and Shan (n 8) 139. See also Article 1102 (NT) and 1103 (MFN) of the NAFTA.

<sup>11</sup> Yuri Shima, ‘The Policy Landscape for International Investment by Government-Controlled Investors: A Fact Finding Survey’ (OECD Publishing 2015) 2015/01 11–3 <<http://dx.doi.org/10.1787/5js7svp0jkns-en%0AOECD>> accessed 12 September 2017. See more in Ch 2.

<sup>12</sup> For example, Article II (2) (c) of the US BITs with Moldova, Ecuador, Belarus, Ukraine, Estonia, Latvia, and Lithuania, Vandeveldt, *U.S. International Investment Agreements* 462.

<sup>13</sup> NAFTA, Article 1503 (3) provides that ‘each Party shall ensure that any state enterprise that it maintains or establishes accords non-discriminatory treatment in the sale of its goods or services to investments in the Party’s territory of investors of another Party’. Similar provisions are adopted in FTAs of the US with Chile, Australia, Peru and Columbia.

services. Such a provision is omitted in later BITs and FTAs of the US, but has resurfaced in some recent FTAs such as the US-Singapore FTA.<sup>14</sup>

### *B. Qualifiers and exceptions*

However, the application of NDT to SOEs is not without conditions and exceptions. To the contrary, NDT rules under most treaties are subject to certain qualifications and exceptions, which undoubtedly apply to SOE investors. First, NDT of SOEs under most investment treaties applies only after the SOE investment has been made in the host state (post-establishment). In this respect, traditional investment treaties, especially those negotiated by EU member states merely provide post-establishment non-discriminatory treatment that leaves host states free to impose a discriminatory requirement on the admission of foreign SOEs.<sup>15</sup> In contrast, US treaties normally extend non-discrimination treatment to both pre-establishment and post-establishment stages.<sup>16</sup> As noted in Chapter 3, many recent treaty practices have broken away from traditional policy by accepting pre-establishment national treatment with a ‘negative list’ of reserved sectors, such as the CETA and Chinese BIT negotiations with the EU and the US.<sup>17</sup> Even if a pre-establishment national treatment commitment has been made, the host country may still use a ‘negative list’ or a ‘positive list’ to limit national treatment and protect certain national industries or

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<sup>14</sup> See Article 12.3.2 (d) of the US-Singapore FTA. The reason for omitting such a provision is because the same protection in this regard has already been provided by the general NT and MFN provisions, see Vandevelde (n 12).

<sup>15</sup> For example, Article 3 (2) of the UK-Egypt BIT provides:

(1) Neither Contracting Party shall in its territory subject investments or of nationals or companies of the other Contracting Party to treatment favorable than that which it accords to investments or returns of its nationals or companies or to investments or returns of nationals or companies of any third State.  
(2) Neither Contracting Party shall in its territory subject nationals or companies of the other Contracting Party, as regards their management, use, enjoyment or disposal of their investments, to treatment less favorable than that which it accords to its own nationals or companies or to national companies of any third State.

Dlozer and Schreuer (n 10) 199. See also Ch 3.

<sup>16</sup> For example, Article 1102 (1) of the NAFTA provides that, ‘[e]ach Party shall accord to investors of another Party treatment no less favorable than that it accords, in like circumstances, to its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments’.

<sup>17</sup> Shan and Zhang, ‘Market Access Provisions in the Potential EU Model BIT: Toward a “Global BIT 2.0”?’ 441. See more in Ch 3.



activities.<sup>18</sup> Hence, foreign SOEs may be treated differently in host countries under different treaty practices, and the precise scope of non-discriminatory treatment of foreign SOEs has to be determined by provisions in the specific treaty. For example, the US ‘negative list’ rarely limits foreign ownership to a certain percentage of an investment, while Chinese practice does so across many sectors.<sup>19</sup> Nonetheless, even under a post-establishment investment treaty, the host state may still deny offering NDT to SOEs if the SOE investment does not comply with national laws and legislations.

The second contextual qualifier of NDT for SOEs is the ‘in like circumstances’ phrase. US treaties, for instance, traditionally specify that NDT provisions only apply ‘in like situations’ or ‘in like circumstances’.<sup>20</sup> In this context, only ‘in like circumstances’ will treatment less favourable to foreign SOEs than that accorded to comparators by a host state trigger non-discrimination obligations. Some argue that a comparative context is implicitly required by NT and MFN even if there is no explicit language to this effect.<sup>21</sup> However, investment treaties with an ‘in like circumstances’ phrase make it clear that the likeness of the circumstances is a mandatory component of analysis.

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<sup>18</sup> The ‘positive list’ approach is typical in GATS type treaties and the ‘negative list’ approach is typical in the NAFTA or US treaties, UNCTAD, *National Treatment: UNCTAD Series on Issues in International Investment Agreements* (UN Publication 1999) 68. It is the same in MFN clauses, see UNCTAD, *Most-Favoured-Nation Treatment: UNCTAD Series on Issues in International Investment Agreement II* (UN Publication 2010) 42.

<sup>19</sup> See USCBC, ‘Summary of US Negative Lists in Bilateral Investment Treaties’ (2014) <<https://www.uschina.org/sites/default/files/Negative%20list%20summary.pdf>> accessed 12 September 2017. Notably, China has announced its intention to reduce foreign investment restrictions, and to adopt a negative-list approach that promises a higher degree of openness, Xinhua, ‘China to reduce foreign investment restrictions’ *China Daily* (Beijing 5 March 2015) <[http://www.chinadaily.com.cn/china/2015twosession/2015-03/05/content\\_19731187.htm](http://www.chinadaily.com.cn/china/2015twosession/2015-03/05/content_19731187.htm)> accessed 12 September 2017.

<sup>20</sup> See e.g., 1994 US Model BIT, Article II.1. In recent years US practice has changed the reference from ‘in like situation’ to ‘in like circumstance’, see Article 3 of the 2004 and 2012 US Model BITs. Scholars consider that the change from ‘in like situations’ to ‘in like circumstances’ indicates that for the US Government there is a nuance between these two versions that deserves attention, Dlozer and Schreuer (n 10) 198. The reference to ‘in like circumstances’ can also be found in other treaties, e.g., Mexico-Iceland BIT, Article 3 (2)-(3); Canada-Uruguay BIT, Article IV; Japan-Vietnam BIT, Article 2; NAFTA, Article 1102, 1103; etc.

<sup>21</sup> This was also argued by some delegations during the MAI negotiations, UNCTAD, *Most-Favoured-Nation Treatment* (n 18) 26. Also, Vandevelde considers that national and MFN treatment are assumed to be compared only to the treatment of comparable investments, thus even where a phrase such as ‘in like circumstances’ or ‘in like situation’ does not appear in the provision, such a limitation should be treated as implicit, Vandevelde, *Bilateral Investment Treaties: History, Policy, and Interpretation* 340–1.

Regardless of whether the ‘in like circumstances’ condition is expressly stated or implied, it may restrict the application of NDT to SOEs to a certain context. In other words, the ‘in like circumstances’ requirement may provide a safeguard to host states to exclude SOE investors from NDT protections on the basis of different ownership. Here a key issue is whether the ownership is a criterion of ‘likeness’. However, most treaties are silent on the meaning of ‘in like circumstances’ or ‘in like situations’. To that extent, the scope of the comparator is still ambiguous, leaving it uncertain whether different treatment could be accorded to SOEs and other investors on the basis of their ownership structure. It is noted that several recent treaties have attempted to set criteria of ‘in like circumstances’ to clarify the NDT standard and provide more guidance to tribunals in identifying an appropriate comparator.<sup>22</sup>

Most notably, the recent draft Model BIT of India highlights that ‘whether the investment is public, private, or state-owned or controlled’ is one of the important elements to be considered for assessing ‘like circumstances’.<sup>23</sup> Although such clarification may not aim to discriminate against foreign SOEs - perhaps more likely to protect domestic SOEs due to the large amounts of interests of SOEs in India<sup>24</sup> - it manifests that the treatment accorded to an SOE investor can be different from that accorded to a non-SOE investor since they are not ‘in like circumstances’. However,

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<sup>22</sup> For example, Article 4 (2) of the Azerbaijan–Croatia BIT (2007) provides:

For greater certainty, the concept of ‘in like circumstances’ requires an overall examination, on a case-by-case basis, of all the circumstances of an investment, including, inter alia: i. its effects on third persons and the local community; ii. its effects upon the local, regional or national environment; iii. The sector the investor is in; iv. The aim of the measure of concern; v. the regulatory process generally applied in relation to a measure of concern; and vi. other factors directly relating to the investment or investor in relation to the measure of concern. The examination shall not be limited or biased towards any one factor.

Similar provision see also Article 17 of the COMESA Investment Agreement (2007, not in force).

<sup>23</sup> According to the draft Indian model BIT (2015), the requirement of ‘like circumstances’ recognises that states may have various legitimate reasons for distinguishing between investments including, but not limited to, (a) the goods or services consumed or produced by the Investment; (b) the actual and potential impact of the Investment on third persons, the local community, or the environment, (c) whether the Investment is public, private, or state-owned or controlled, and (d) the practical challenges of regulating the Investment, see Article 4.1 of the Indian 2015 Model BIT

<[https://www.mygov.in/sites/default/files/master\\_image/Model%20Text%20for%20the%20Indian%20Bilateral%20Investment%20Treaty.pdf](https://www.mygov.in/sites/default/files/master_image/Model%20Text%20for%20the%20Indian%20Bilateral%20Investment%20Treaty.pdf)> accessed 12 September 2017.

<sup>24</sup> According to Forbes Global 2000, the majority of 260 largest companies are from China and India; the market value of SOEs in India amounts to 225 of GNI and the Country SOE Share (CSS) is 58.9, Przemysław Kowalski and others, ‘State-Owned Enterprises: Trade Effects and Policy Implications’ (OECD 2013) 147, 21

<<http://dx.doi.org/10.1787/5k4869ckqk7l-en>> accessed 12 September 2017.

such provisions are exceptional in treaty practice, and most IIAs do not provide any further clarification, in which the issue of whether an SOE investor and a non-SOE investor are comparable ‘in like circumstances’ has to be determined by investment arbitral tribunals.

Finally, the scope of NDT to SOEs may also be qualified by various express exceptions and reservations in IIAs, including general exceptions and other specific exceptions. Many IIAs provide general exceptions, typically on the basis of public health, order and morals, and national security, which apply to all provisions of the investment treaty including NDT.<sup>25</sup> Other treaties tend to provide ‘essential security interests’ as an exception to IIA obligations,<sup>26</sup> which enables states to continue to review and prohibit or suspend foreign acquisitions or mergers because of their possible threat to national security.<sup>27</sup> There are also treaties that provide specific exceptions of NDT, especially exceptions for specific industrial sectors or types of measures.<sup>28</sup> Chapter 5 will further discuss treaty exceptions in detail.

As a result, the extent of the NDT treatment of SOE investors is subject to various general and specific exceptions and restrictions. Host states may not grant SOE investors NDT at all times and in all circumstances. Although most (if not all) restrictions or exceptions of NDT do not specifically target SOE investors, some may be of exceptional importance to SOE investors, such as the ‘in like circumstances’ requirement and national security exceptions, because they may provide a ground for host states to differentiate SOE investors from non-SOE investors without a violation of NDT obligations. Nonetheless, to ascertain whether

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<sup>25</sup> For example, Article 2102 of NAFTA, Article 24 of ECT, Article XIV of the GATS. UNCTAD, *National Treatment* (n 18) 44; UNCTAD, *Most-Favoured-Nation Treatment* (n 18) 46.

<sup>26</sup> See e.g., Article 18 of the US 2012 Model BIT.

<sup>27</sup> Richard C Levin and Susan Erickson Martin, ‘NAFTA Chapter 11: Investment and Investment Disputes’ (1996) *Law & Business Review of the America* 82, 82.

<sup>28</sup> Specific industrial sectors typically include petroleum, hydrocarbon and cultural industries, while specific types of measures typically include taxation measures, government subsidies and grants, government procurement, etc. For example, US 2012 Model BIT Article 14 (4) & (5), NAFTA Article 1108 (7), Canada-Peru BIT Article 16. See UNCTAD, *National Treatment* (n 18) 45; Adrian Blundell-Wignall and Gert Wehinger, ‘Open Capital Markets and Sovereign Wealth Funds, Pension Funds, and State-Owned Enterprises’ in RA Fry, WJ McKibbin and J O’Brien (eds), *Sovereign Wealth: The Role of State Capital in the New Financial Order* (Imperial College Press 2011) 189–91.

and to what extent an SOE investor can enjoy NDT treatment, it is essential to take all relevant provisions into account.

#### 4.2.2 Addressing Host States' Concerns under NDT Rules

While SOE investments may bring huge benefits regarding growth, employment, and transfer of technology to the host economy,<sup>29</sup> they may have potentially negative effects on national security or competitive neutrality which need to be prevented or mitigated by measures of the host states.<sup>30</sup> Therefore, an ideal NDT provision design, as with other rules under IIAs, should be able to promote and protect SOE investments while addressing the legitimate concerns of the host states.<sup>31</sup>

As noted above, traditional investment treaties tend to be rather short and focused on investment protection with little attention paid to the need to preserve the regulatory space of host states. As a result, they typically offer NDT protection to all kinds of investments including SOE investments with few or no safeguarding restrictions such as the 'in like circumstances' requirements or other general or specific exceptions. However, many recent treaty practices have attempted to address the legitimate concerns of host states by the inclusion of a series of important restrictions and exceptions.

Chapter 1 has indicated that the most significant concerns relating to SOE investments are twofold: national security and competitive neutrality, both of which can be addressed in some of the recent investment treaties. More specifically, national security concerns related to SOE investors can be addressed by security exceptions, including national or essential security exceptions, or other exception

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<sup>29</sup> UNCTAD, *World Investment Report 2014 - Investing in the SDGs: An Action Plan* (UN Publication 2014) 21–2; Hans Christiansen and Yunhen Kim, 'State-Invested Enterprises in the Global Marketplace: Implications for a Level Playing Field' (2014) 14, 47 <<http://dx.doi.org/10.1787/5jz0xvfv16nw-en%0AOECD>> accessed 12 September 2017.

<sup>30</sup> See e.g., Karl P Sauvart, Lisa E Sachs and Wouter P.F. Schmit Jongbloed (eds), *Sovereign Investment: Concerns and Policy Reactions* (OUP 2012) 16–21; Antonio Capobianco and Hans Christiansen, 'Competitive Neutrality and State-Owned Enterprises: Challenges and Policy Options' (2011) 1 <<http://dx.doi.org/10.1787/5kg9xfjdhg6-en>> accessed 12 September 2017, 5.

<sup>31</sup> See also Ch 1.

clauses under recent IIAs.<sup>32</sup> Although these exceptions apply to all foreign investors, they can sufficiently address national security risks concerning SOE investors. For example, the 2012 US Model BIT has an essential security interests exception, which stipulates that:

nothing in this Treaty shall be construed to preclude a Party from applying measures that it considers necessary for the fulfilment of its obligations with respect to the maintenance or restoration of international peace or security, or the protection of its own essential security interests.<sup>33</sup>

Also, more and more treaties now contain a general exception clause to stipulate that it be ‘necessary to protect human, animal or plant life or health’ or ‘necessary for the conservation of exhaustible natural resources’.<sup>34</sup> With such exceptions, host states may prohibit or restrict certain SOE investments on grounds of national security without breaching the NDT obligation. Chapter 6 will discuss this in detail.

The competitive neutrality (CN) concern is a more complex issue. To start with, no consensus has been reached on the concept and contents of CN *per se*.<sup>35</sup> Although it is agreed that the concept aims to prevent SOEs from gaining competitive advantages merely on the basis of their state ownership status, it is far from clear what kind of behaviour relating to SOEs should be prohibited or restricted and how.<sup>36</sup> Indeed, no state has achieved or has intended to achieve absolute competitive neutrality in their domestic market. As a matter of fact, developed states actually own the bulk of SOEs in terms of sales, assets and market valuation.<sup>37</sup> Indeed, SOEs are essential for states to achieve certain goals, strategic, security, industrial or

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<sup>32</sup> Although national security exceptions were included in traditional IIAs only sporadically, their inclusion has been much more frequent in recent treaties, UNCTAD, *World Investment Report 2015 - Reforming International Investment Governance* 141.

<sup>33</sup> Article 18 of the 2012 US Model BIT.

<sup>34</sup> For example, Article 9.8 of the Australia-China FTA, Article 22 of the Japan-Uruguay BIT, Article 17 of the Canada-Côte d’Ivoire BIT, etc. *ibid* 112–3; UNCTAD, *WIR 2014* (n 29) 116–7.

<sup>35</sup> According to the OECD report, competitive neutrality implies that no business entity is advantaged (or disadvantaged) solely because of its ownership. In Australian law, competitive neutrality requires that government business activities should not enjoy net competitive advantages over their private sector competitors simply by virtue of public sector ownership. Capobianco and Christiansen (n 30) 3, 5. Currently the study on competitive neutrality in international law context is still at the fact-finding stage.

<sup>36</sup> Kowalski and others (n 24) 37–42.

<sup>37</sup> *ibid* 21.

otherwise.<sup>38</sup> As a result, it is unrealistic to expect all anti-CN measures to be prohibited or restricted in investment treaties. Like the concept of state sovereignty, that of competitive neutrality is an essentially contested concept, the specific contents of which are subject to continuous debates and bargains.

Nevertheless, to a certain extent, competitive neutrality concerns can still be addressed by two main aspects of the NDT rules under some recent IIAs, namely, the ‘in like circumstances’ requirement and the public policy exception.

#### *A. Competitive neutrality and the ‘like circumstances’ qualification*

It might be argued that state ownership may change the ‘likeness’ of circumstances and on this basis, the host state may have a basis for treating foreign SOE investors differently from others. As mentioned above, very few treaties have attempted to clarify ‘in like circumstances’, and only the new Indian draft Model BIT has referred to ‘ownership’ as one of the important elements to be considered when determining ‘like circumstances’.<sup>39</sup> However, it does not give any further indications as to how state ownership might change the circumstances.

In practice, tribunals have presumed to identify entities in like circumstances and the primary approach used is the ‘competitive relationship’ test.<sup>40</sup> The argument here is that the relative standards aim to ensure a level playing field as well as to prohibit discrimination among competitors.<sup>41</sup> Most early cases, including *S.D. Myers v. Canada*, *Pope & Talbot v. Canada*, *Feldman v. Mexico*, and *ADF v. US*, regarded certain forms of ‘competition’ as a condition of ‘likeness’ in an NT inquiry.<sup>42</sup> In the *S.D. Myers* case, the tribunal considered that the concept of ‘like circumstances’ invites an examination of whether or not a non-national investor is in the ‘same

<sup>38</sup> Capobianco and Christiansen (n 30) 8–9.

<sup>39</sup> See Article 4.1 of Model Text for the Indian Bilateral Investment Treaty (n 23).

<sup>40</sup> Andrea K Bjorklund, ‘The National Treatment Obligation’ in Katia Yannaca-Small (ed), *Arbitration Under International Investment Agreement: A Guide to the Key Issue* (OUP 2010) 422.

<sup>41</sup> Vandevelde, *Bilateral Investment Treaties: History, Policy, and Interpretation* (n 21) 341.

<sup>42</sup> Anne van Aaken and Jürgen Kurtz, ‘Prudence or Discrimination? Emergency Measures, the Global Financial Crisis and International Economic Law’ (2009) 12 *Journal of International Economic Law* 859, 885.

sector’ as the national investor.<sup>43</sup> The ‘sector’ has a wide connotation that includes the concepts of ‘economic sector’ and ‘business sector’.<sup>44</sup> From a business perspective, it was clear that SDMI and Myers Canada were in ‘like circumstances’ with Canadian operators because they were in a competitive relationship.<sup>45</sup> In *Pope & Talbot v. Canada*, the tribunal focused on the relevant business and economic sector to find the appropriate comparator.<sup>46</sup> In *Feldman*, the tribunal’s view was that, ‘...the “universe” of firms in like circumstances is those foreign-owned and domestic-owned firms that are in the same business...’<sup>47</sup>

Notably, some tribunals took a broader or narrower interpretation in establishing the existence of ‘like circumstances’ without examining the role of the competitive relationship. For example, in *Occidental v. Ecuador*, the tribunal adopted a much broader approach by ruling that a foreign investor involved in oil exports was ‘like’ domestic companies exporting non-oil-related goods such as flowers and seafood products. The tribunal explained that, ‘the purpose of national treatment is to protect investors as compared to local producers, and this cannot be done by addressing exclusively the sector in which that particular activity is undertaken’.<sup>48</sup> In contrast, the later *Methanex* tribunal adopted a much narrower approach requiring identification of an ‘identical’ comparator to the foreign investor.<sup>49</sup> However, both the broader and narrower interpretations prove to be rare in arbitral practice, and tribunals have largely returned to a competition-based reading of ‘in like circumstances’ in an NT inquiry.<sup>50</sup> For example, in *ADM v Mexico*, the tribunal reaffirmed the competitive relationship test in identifying the in like circumstances given that the investor and the comparators ‘compete face to face in the same

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<sup>43</sup> *S.D. Myers, Inc. v. Government of Canada*, UNCITRAL, Partial Award, 13 November 2012, para 250.

<sup>44</sup> *ibid.*

<sup>45</sup> *ibid* 251.

<sup>46</sup> *Pope & Talbot Inc. v. The Government of Canada*, UNCITRAL, Award on the Merits of Phase 2, 10 April 2001, para 78.

<sup>47</sup> *Marvin Roy Feldman Karpa v. United Mexican States*, ICSID Case No. ARB (AF)/99/1, Award, 16 December 2002, para 171.

<sup>48</sup> *Occidental Exploration and Production Company v. The Republic of Ecuador*, LCIA Case No. UN3467, Final Award, 1 July 2004, para 173.

<sup>49</sup> *Methanex Corporation v. United States of America*, UNCITRAL, Final Award of the Tribunal on Jurisdiction and Merits, 3 August 2005, Part IV-Ch- B, para 17.

<sup>50</sup> Aaken and Kurtz (n 42).

market'.<sup>51</sup> The tribunal also held that, 'when no identical comparators exist, the foreign investor may be compared with less like comparators, if the overall circumstance of the case suggests that they are in like circumstances'.<sup>52</sup>

The *UPS v. Canada* case is of particular relevance on this issue. In this case, UPS alleged that Canada's Publications Assistance Program (PAP) violated national treatment under NAFTA because it only applied to Canada Post (CP), an SOE of Canada. The majority held that UPS and CP were *not* in like circumstances given that CP was the *only* company that could deliver post to every address in Canada due to its statutory obligations to do so.<sup>53</sup> The dissenting arbitrator, however, considered that the two companies were indeed in like circumstances, as UPS claimed that it was able to achieve universal or virtually universal delivery.<sup>54</sup> In this case, both the majority and the dissenting arbitrator did not waste time in analysing the fact that CP was an SOE, and the implications of this SOE status. Rather, they concentrated on the actual conditions under which the two companies competed against each other.

The aforementioned cases, particularly the *UPS* case, show that tribunals tend to focus their analyses on the competitive relationship between the foreign investor and the comparator domestic investor. No tribunal seems to have paid much attention to the 'ownership' of the companies concerned. However, the 'ownership' element actually played a role in the *UPS* case, albeit indirectly. CP enjoyed the subsidy under the PAP program mainly because CP was able to carry out universal delivery, and the reason that it could do so was because as an SOE it had been required to do so for a long period. The majority in the case effectively acknowledged that SOEs undertook special obligations to the state, and consequently it was legitimate that they enjoyed certain special benefits from the state. Foreign investors, since they did

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<sup>51</sup> *Archer Daniels Midland Company and Tate & Lyle Ingredients Americas, Inc. v. The United Mexican States*, ICSID Case No. ARB (AF)/04/5, Award, 21 November 2007, para 201. Likewise, in *CPI v. Mexico*, the tribunal concluded that the 'in like circumstances' requirement was satisfied on the basis that Mexican sugar producers operated in the same business or economic sectors as CPI and their products were in direct competition with one another, *Corn Products International, Inc. v. United Mexican States*, ICSID Case No. ARB (AF)/04/1, Decision on Responsibility, 15 January 2008, para 120.

<sup>52</sup> *ADM* (n 51), paras 197-202.

<sup>53</sup> *United Parcel Service of America Inc. v. Government of Canada*, UNCITRAL, Award on Merits, 24 May 2007, para 173.

<sup>54</sup> *ibid*, Dissenting Opinion, paras 94, 133.



not wish to undertake the same obligations to the state, were not in ‘like circumstances’ as such SOEs, and hence could not claim the same benefits. Essentially, it was Canadian policy and practice on an SOE in a given industry that justified the discriminatory treatment to foreign investors. In other words, the ‘ownership’ element could somehow play a role in the determination of ‘like circumstances’. However, it remains to be seen how this might work out in a case where a host state might invoke the ‘like circumstances’ qualification to justify its discriminatory measures against foreign SOE investors. What is certain is that the ‘ownership’ element will be considered under a treaty that expressly includes ownership as an element of ‘like circumstances’, as in the new draft Indian Model BIT.

### *B. Competitive neutrality and public policy*

Whereas traditional IIAs typically do not contain express public policy exceptions, an increasing number of new treaties do include them. The formulation of such exceptions is often modelled on Article XX of GATT or Article XIV of GATS.<sup>55</sup> These provisions aim to balance investment protection with other public policy objectives and to reduce states’ exposure to investor challenges of such measures.<sup>56</sup> In practice, some tribunals have addressed that reasonable public policy can justify different or discriminatory treatment.<sup>57</sup> In this context, different treatment of SOE investors on the basis of CN concerns can be justified in investment law context if CN is a rational public policy objective.

However, IIA jurisprudence does not provide clear guidance on what amounts to a ‘legitimate’ public policy goal to justify differentiation. In *Pope & Talbot*, for example, the tribunal held that rational policies were ‘not motivated by the preference of domestic over foreign owned investments’.<sup>58</sup> In *Occidental*, the tribunal did not discuss the motive of a government policy (a tax regulation), but

<sup>55</sup> See e.g., Article 10 of the 2004 Canadian Model BIT, Article 83 of the Japan-Singapore FTA (2002), Article 200 of the China-New Zealand FTA (2008). Newcombe and Paradell (n 5) 500.

<sup>56</sup> UNCTAD, *WIR 2015* (n 32) 140.

<sup>57</sup> See e.g., *UPS* (n 53), paras 98, 119; *Pope & Talbot* (n 46), para 76; *Gami Investments, Inc. v The Government of the United Mexican States*, UNCITRAL, Award, 15 November 2004, para 114.

<sup>58</sup> *Pope & Talbot* (n 46), para 79. *S.D. Myer* (n 43) para 298.

stated that ‘the purpose of national treatment in this dispute...is to avoid exporters being placed at a disadvantage in foreign markets because of the indirect taxes paid in the country of origin’.<sup>59</sup> In *Saluka v. the Czech Republic*, the tribunal looked at a range of different criteria in assessing whether differential treatment of IPB was justified by state financial assistance by the Czech Republic.<sup>60</sup> Nevertheless, some investment arbitration awards have provided indications on how tribunals might assess the rationales for differentiation.<sup>61</sup> For example, the *Pope & Talbot* tribunal held that differences in treatment should have ‘a reasonable nexus to rational government policies’.<sup>62</sup> Likewise, the tribunal in *GAMI* stated that different treatment must be ‘plausibly connected with a legitimate goal of policy (ensuring that the sugar industry was in the hands of solvent enterprises) and...applied neither in a discriminatory manner nor as a disguised barrier to equal opportunity’.<sup>63</sup> With regard to the governmental implementation of public policy, some tribunals have noted that political considerations (such as politics and nationalistic reasons) decrease the reasonableness of a host state’s conduct;<sup>64</sup> while an inclusion in domestic law may strengthen the rationale of such conduct.<sup>65</sup> Also, a dissenting opinion in *UPS* addressed that states must articulate *ex ante* rationales to justify their actions rather than rationalise *ex post facto* its discriminatory conduct.<sup>66</sup> A separate statement commented that:

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<sup>59</sup> *Occidental* (n 48) para 175.

<sup>60</sup> *Saluka Investments B.V. v. The Czech Republic*, UNCITRAL, Partial Award, 17 March 2006, paras 327-347.

<sup>61</sup> Suzanne A Spears, ‘The Quest for Policy Space in A New Generation of International Investment Agreements’ (2010) 13 *Journal of International Economic Law* 1037, 1059; Aaken and Kurtz (n 42) 888.

<sup>62</sup> *Pope & Talbot* (n 46) para 78. In this context, the tribunal also suggested recognising that the fundamental purposes of NAFTA, as expressed in its Article 102, might need to supplement the test.

<sup>63</sup> *GAMI* (n 57), para 114.

<sup>64</sup> See e.g., *Inmaris Perestroika Sailing Maritime Services GmbH and Others v. Ukraine*, ICSID Case No. ARB/08/8, Award, 1 March 2012, para 265; *Eureko B.V. v. Republic of Poland*, Partial Award, 19 August 2005, para 233; *Azurix Corp. v. The Argentine Republic*, ICSID Case No. ARB/01/12, Award, 14 July 2006, para 118; *Biwater Gauff (Tanzania) Ltd. v. United Republic of Tanzania*, ICSID Case No. ARB/05/22, Award, 24 July 2008, para 500.

<sup>65</sup> For example, in *ADF v. United States*, the tribunal noted that ‘something more than simple illegality or lack of authority under the domestic law of State is necessary to render an act or measures inconsistent with FET’, *ADF Group Inc. v. United States of America*, ICSID Case No. ARB (AF)/00/1, Award, 9 January 2003, para 190. In *Noble Venture v. Romania*, the tribunal observed that the process of privatisation was not arbitrary given it was the only solution to the company’s insolvency and was conducted in accordance with Romanian law, *Noble Ventures, Inc. v. Romania*, ICSID Case No. ARB/01/11, Award, 12 October 2005, para 182.

<sup>66</sup> Newcombe and Paradell (n 5) 180.

Canada [host state] may be free to adopt any reasonable design to implements its policy... But it is not free to assert for the first time during a dispute resolution proceeding an *ex post* rationalisation that would limit the availability of a government benefit to a single [domestic] recipient.<sup>67</sup>

To ensure the regulatory authority of states and to avoid an overly discretionary review by arbitration tribunals regarding the grounds of differential treatment, some new IIAs have adopted express public policy exceptions. Such inclusions explicitly allow for measures - which might otherwise be challengeable under the agreement - to be taken by host states under specified circumstances without a breach of NDT standards. In so doing, states can have an important effect in increasing certainty and predictability about the scope of the IIA's obligations.<sup>68</sup> For example, the Norwegian 2015 Model BIT provides that:

[T]he Parties agree/ are of the understanding that a measure applied by a government in pursuance of legitimate policy objectives of public interest such as the protection of public health, human rights, labour rights, safety and the environment, although having a different effect on an investment or investor of another Party, is not inconsistent with national treatment and most favoured nation treatment when justified by showing that it bears a reasonable relationship to rational policies not motivated by preference of domestic over foreign owned investment.<sup>69</sup>

However, governments should remain very cautious in regulating SOE investment given that the distinction between arbitrary conduct and legitimate regulations can be very vague. Government conduct targeted at SOEs is still potentially deemed as arbitrary if based on a political and discriminatory motive. To avoid possible risks, the transparency and certainty of government measures with regard to SOEs may be called upon to refrain from arbitrary conduct of states and to protect the 'legitimate expectations' of SOE investors.

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<sup>67</sup> *UPS* (n 53), Award on Merits and Separate Statement of Dean Ronald A. Cass, 24 May 2007, para 124.

<sup>68</sup> UNCTAD, *WIR 2014* (n ) 140.

<sup>69</sup> Article 3 of the Norwegian 2015 Model BIT.

Also, the risk of arbitration has to be noted. As Jan Paulsson stated, ‘arbitration without privity is a delicate mechanism. A single incident of an adventurist arbitrator going beyond the proper scope of his jurisdiction in a sensitive case may be sufficient to generate a backlash’.<sup>70</sup> In this context, host states may not be willing to delegate too much flexibility to investment arbitrators to determine what legitimate regulation of sovereign investors is.<sup>71</sup> Although one may argue that the most effective response would be the development of a ‘prudent and sound investment practice’ on these questions,<sup>72</sup> it is necessary for governments to consider what measures they could take to ensure that sensible domestic regulation of SOEs is not undermined by one or more ‘adventurist arbitrators’.<sup>73</sup> One way forward might be to expressly include competitive neutrality in the list of public policy objectives, making sure that this element must be considered as an exception.

### 4.3 Fair and Equitable Treatment of SOE Investments

We now turn to the most important international investment protection - fair and equitable treatment.<sup>74</sup> As an ‘absolute’ standard of investment protections, FET obliges the host state to provide foreign investments with certain standards - here is fair and equitable - treatment, without reference to how they treat other investments or entities.<sup>75</sup> In contrast to NT and MFN, a violation of FET does not need discrimination on the basis of nationality. Hence, different treatment on the basis of other factors such as ownership that do not breach NDT may constitute a violation of FET. However, the precise contents and parameters of this standard remain ambiguous and controversial.<sup>76</sup> As a result, tribunals have considerable discretion in

<sup>70</sup> Jan Paulsson, ‘Arbitration Without Privity’ (1995) 10 ICSID Review 232, 257.

<sup>71</sup> Poulsen, ‘Investment Treaties and the Globalisation of State Capitalism: Opportunities and Constraints for Host States’ 86.

<sup>72</sup> Feldman, ‘The Standing of State-Owned Entities under Investment Treaties’ 636–7.

<sup>73</sup> Poulsen (n 71) 80.

<sup>74</sup> Scholars have noted that FET is the most frequently and successfully invoked standard of treatment under investment treaties, Jonathan Bonnitcha, Lauge N Skovgaard Poulsen and Michael Waibel, *The Political Economy of the Investment Treaty Regime* (OUP 2017) 92–3; Dlozer and Schreuer (n 10) 137.

<sup>75</sup> Bonnitcha, Poulsen and Waibel (n 74) 93; UNCTAD, *Fair and Equitable Treatment: UNCTAD Series on Issues in International Investment Agreements II* (UN Publication 2012) 6.

<sup>76</sup> The two concepts included in the FET standard, namely ‘fairness’ and ‘equity’, are ‘inherently subjective and therefore lacking in precision’, UNCTAD, *International Investment Agreements: Key Issues (Volume I)* (UN Publication 2004) 212; Kalicki and Medeiros (n 5) 25.

determining the standard, which has resulted in a lack of uniformity in arbitral practice.

Despite the inherent problems of FET, problems may arise where foreign SOEs are involved. For instance, Chapter 1 and Chapter 3 have indicated that some countries have strengthened regulations on foreign SOEs. In such cases, foreign SOEs may wish to enjoy (at least) FET protections in host states, while the state may be concerned that FET obligations unduly constrain their right to regulate foreign SOEs. Furthermore, FET protection can afford foreign SOEs effective protection against the arbitrary and discriminatory conduct of host states. While international investment and trade laws generally permit the state to take measures to regulate foreign investments, they are opposed to economic protectionism. However, the undefined and broad formulation of FET may make it difficult to distinguish legitimate regulation from investment protectionism. The following part, therefore, will focus on FET and its application to SOE investments.

#### 4.3.1 SOE Investments and FET Provisions

Since the first reference to ‘equitable’ treatment found in the 1948 Havana Charter for an International Trade Organisation, FET has been widely adopted in current international agreements.<sup>77</sup> However, the formulation and language of FET in IIAs varies significantly. The typical formulation of the FET standard of investment treaties provides that ‘each contracting party shall in any case accord investments fair and equitable treatment’.<sup>78</sup> Some treaties combine FET with other standards, including the guarantee of protection and security,<sup>79</sup> the obligations of MFN and

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<sup>77</sup> Dlozer and Schreuer (n 10) 130–2. Some Asian countries such as Pakistan, Saudi Arabia and Singapore are reluctant to include the FET standard in their BITs in the beginning. But, in recent years, even countries which traditionally were in favour of NT over FET have incorporated the FET standard in their BIT. Nevertheless, Latin American countries, which have embraced the Calvo doctrine since the beginning of the XXth Century have firmly avoided the terms ‘fair and equitable’, OECD, ‘Fair and Equitable Treatment Standard in International Investment Law’ (OECD Publishing 2004) 2004/3, 5 <<http://dx.doi.org/10.1787/675702255435>> accessed 12 September 2017.

<sup>78</sup> See e.g., Article 4 (1) of the Argentina-Spain BIT provides that ‘each Party shall accord in its territory fair and equitable treatment to investments made by investors of another Party’. See also Article 2 (1) of the Germany-Botswana BIT (2000). Such provisions are typical in German and Austrian BITs, see e.g., 1994 Austria Model BIT, etc.

<sup>79</sup> See e.g., Article II (2) of the Cambodia-Cuba BIT (2001), which provides that, ‘Investments of investors of

NT,<sup>80</sup> and the duty to refrain from arbitrary and discriminatory treatment.<sup>81</sup> Some treaties clarify that FET should be accorded at *all times*,<sup>82</sup> while others do not contain such language.<sup>83</sup>

In the majority of treaty provisions, the FET standard is accorded to ‘investment’ or ‘covered investment’ rather than ‘investor’, without any distinction of ownership. Hence, whatever specific language has been adopted in the treaty, SOE investments shall normally be granted FET protections by the host state. One exception is when the SOE investment is not a covered investment under the treaty. For example, if the treaty provides protection of investments in accordance with local laws and an SOE investment does not comply with the national requirement, the SOE investor may not be able to enjoy FET.

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either contracting party shall at all times be accorded fair and equitable treatment and shall enjoy adequate protection and security in the territory of the other contracting party’. See also Article 2 (2) of the Germany Model BIT (1998); Article 9 (1) of the Japan-Vietnam BIT (2003); Article 3 (a) of the US-Ecuador BIT (1993); etc.

<sup>80</sup> See e.g., Article 3 (2) of the Switzerland Model BIT (1986), which provides that:

[E]ach contracting party shall ensure fair and equitable treatment within its territory of the investments of the nationals or companies of the other contracting party. This treatment shall not be less favourable than that granted by each contracting party to investments made within its territory by its own nationals or companies of the most favoured nation, if this latter treatment is more favourable.

See also Article 4 (2) of the Switzerland-Chile BIT (1999); Article 4 of the Bangladesh-Iran BIT (2001); Article 3(1) of the Malaysia-Chile BIT (1992); Article II (2) of the US-Argentina BIT (1991); Article II (3) of the US-Turkey BIT (1985); etc.

<sup>81</sup> See e.g., Article 2 (2) of the Lebanon-Hungary BIT (2001) provides:

[I]nvestments and returns of investors of either contracting party shall at all times be accorded fair and equitable treatment and shall enjoy full protection and security in the territory of the other contracting party. Each contracting party shall refrain from impairing by unreasonable or discriminatory measures the management, maintenance, use, enjoyment, extension, sale or liquidation of such investments.

See also Article II (3) of the US-Estonia BIT (1994); Article III (1) of the Netherlands-Czech and Slovak Republic BIT (1991); Article 2(2) of the Hong Kong Model BIT; Article 3 (1) of the Netherlands Model BIT (1993); Article 2 (2) of the UK Model BIT (1994); Article II (2) (a) of the US-Czech and Slovak Republic BIT (1991); Article 3 of the US-Ecuador BIT (1993); Article II (2) of the US-Argentina BIT (1991); Article II (3) of the US-Turkey BIT (1985); Article 2 of the Germany-Argentina BIT (1991); etc.

<sup>82</sup> See e.g., Article 10 (1) of the ECT (1994) provides:

[E]ach Contracting Party shall, in accordance with the provisions of this Treaty, encourage and create stable, equitable, favourable and transparent conditions for Investors of other Contracting Parties to make investments in its area. Such conditions shall include a commitment to accord at all times to Investments of Investors of other Contracting Parties fair and equitable treatment.

See also Article II (2) (a) of the US-Czech and Slovak Republic BIT (1991); Article 3 (a) of the US-Ecuador BIT (1993); Article II (2) of the US-Argentina BIT (1991); Article II (3) of the US-Turkey BIT (1985); etc.

<sup>83</sup> See e.g., Article 4 (1) of the Argentina –Spain BIT; Article II (3) of the US-Estonia BIT (1994); Article III (1) of the Netherlands-Czech and Slovak Republic BIT (1991); Article 4 (1) of the Spain-Mexico BIT (1995); Article 3(1) of the Malaysia-Chile BIT (1992); Article 2 (1) of the Germany-Argentina BIT (1991); etc.

Although host states grant SOE investments FET protections in most cases, the degree or level of protection may vary depending on the specific wordings adopted by the applicable treaties. For example, some treaties prescribe FET with reference to customary international law, while others do not.<sup>84</sup> In the former case, there is no doubt that the FET standard is meant to be a rule of international law.<sup>85</sup> In the latter case, tribunals tend to interpret the relevant provisions autonomously.<sup>86</sup> However, such interpretation has led to conflicts and uncertainty in the application of the FET standard.<sup>87</sup> Nonetheless, tribunals have increasingly focused on discerning the substantive contents of FET rather than discussing the relationship between FET and the minimum standard of treatment of aliens.<sup>88</sup> However, the elements of FET are subject to disagreement between arbitral tribunals, states, and academics.<sup>89</sup>

Since 2000, some states began to respond to such uncertainty in arbitral jurisprudence in ways that clarify the meaning of FET. For example, representatives of the three NAFTA states in 2001 issued an authoritative interpretation through the NAFTA Free Trade Commission (FTC) which stated that FET does not go beyond the minimum standard of customary international law.<sup>90</sup> However, the joint

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<sup>84</sup> For instance, German, Dutch, Swedish, and Swiss BITs generally without reference to customary international law. By contrast, Article 1105 (1) of NAFTA provides that ‘each Party shall accord to investments of investors of another Party treatment in accordance with international law, including fair and equitable treatment and full protection and security’. Dlozer and Schreuer (n 10) 135.

<sup>85</sup> *ibid* 133.

<sup>86</sup> *ibid* 137. Mann also noted that ‘no standard defined by other words is likely to be material. The terms [FET] are to be understood and applied in dependently and autonomously’, FA Mann, ‘British Treaties for the Promotion and Protection of Investments’ (1982) 52 *British Yearbook of International Law* 241, 244. For arbitral cases, see e.g., *Emilio Agustín Maffezini v. The Kingdom of Spain*, ICSID Case No. ARB/97/7, 13 November 2011, Award, para 83; *Middle East Cement Shipping and Handling Co. S.A. v. Arab Republic of Egypt*, ICSID Case No. ARB/99/6, Award, 12 April 2002, para 143; *Siemens A.G. v. The Argentine Republic*, ICSID Case No. ARB/02/8, Award, 17 January 2007, paras 291, 299-300, 308.

<sup>87</sup> Gallagher and Shan (n 8) 110.

<sup>88</sup> UNCTAD, *Fair and Equitable Treatment* (n 75) 61.

<sup>89</sup> Bonnitca, Poulsen and Waibel (n 74) 109.

<sup>90</sup> As stated by the NAFTA FTC:

Article 1105 (1) prescribes the customary international law minimums standard of treatment of aliens as the minimum standard of treatment to be accorded to investments of investors of another Party.

The concepts of ‘fair and equitable treatment’ and ‘full protection and security’ do not require treatment in addition to or beyond that which is required by the customary international law minimum standard of treatment of aliens...

The interpretation is considered as a response to the ‘additive’ interpretation by the *Pope & Talbot v. Canada* tribunal that ascribed a protective scope of the FET clause beyond the customary international law minimum standard of treatment, *Pope & Talbot* (n 46), paras 110- 17. In fact, the interpretation has disturbed the *Pope &*

interpretation did not solve the debate, since the minimum standard of customary international is itself a subject of disagreement and uncertainty.<sup>91</sup> Nonetheless, a growing number of countries, including but not limited to the NAFTA parties, have contained explicit references linking FET to the customary international minimum standard in investment treaties.<sup>92</sup>

In recent years, a trend of defining FET more precisely within the context of investment treaties is beginning to emerge.<sup>93</sup> For instance, many treaties not only refer to FET as a minimum standard of treatment but also specify the due process of law as the FET obligation.<sup>94</sup> Furthermore, Article 8.10 of the CETA contains a non-exhaustive list of measures that may violate FET obligations, including:

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*Talbot* tribunal and have been accepted by the some subsequent tribunals, such as *Mondev*, *ADF*, and *Merrill. Pope & Talbot* (n 46), Award in Respect of Damages, 31 May 2002, paras 47-69; *Mondev International Ltd. v. United States of America*, ICSID Case No. ARB(AF)/99/2, Award, 11 Oct 2002, para 121; *ADF* (n 65), para 177; *Merrill and Ring Forestry L.P. v. Canada*, ICSID Case No. UNCT/07/1, Award, 31 March 2010, para 192. Wolfgang Alschner, 'The Impact of Investment Arbitration on Investment Treaty Design: Myth versus Reality' (2017) 42 *Yale Journal of International Law* 1, 57; Gabrielle Kaufmann-Kohler, 'Interpretive Powers of the Free Trade Commission and the Rule of Law' in Emmanuel Gaillard and Frédéric Bachand (eds), *Fifteen Years of NAFTA Chapter 11 Arbitration* (JurisNet, LLC 2011) 182–4.

<sup>91</sup> In fact, a number of developing countries have traditionally held reservations as to whether the FET standard is a part of customary international law. Moreover, some tribunals found no basis for equating principles of international law with the minimum standard of treatment, see e.g., *Compañía de Aguas del Aconquija S.A. and Vivendi Universal S.A. v. Argentine Republic*, ICSID Case No. ARB/97/3, Award, 21 November 2000, para 745. See also Stephen Vasciannie, 'The Fair and Equitable Treatment Standard in International Investment Law and Practice' (2000) 70 *British Yearbook of International Law* 99, 139–44; Gallagher and Shan (n 8) 130; Bonnitcho, Poulsen and Waibel (n 74) 113; Alschner (n 90) 57.

<sup>92</sup> See e.g., Australia-Japan EPA (2014), Article 14.5; Japan-Ukraine BIT (2015), Article 5; Colombia-Turkey BIT (2014), Article 4; Australia-Republic of Korea FTA, Article 11.5; Cameroon-Canada BIT (2014), Article 6; Guatemala -Trinidad and Tobago BIT (2013), Article 4 (1); New Zealand-Taiwan Economic Cooperation Agreement (2013), Article 10; Korea-Colombia FTA (2013), Article 8.5; Moldova-Qatar BIT (2012), Article 4; Morocco-Viet Nam BIT (2012), Article 2 (2); Australia-Malaysia FTA (2012), Article 12.7; etc.

<sup>93</sup> Bonnitcho, Poulsen and Waibel (n 74) 113.

<sup>94</sup> For instance, Article 12.5 of the China-Korea FTA (2015) provides:

2. For greater certainty, paragraph 1 prescribes the customary international law minimum standard of treatment of aliens as the minimum standard of treatment to be afforded to covered investments. The concepts of 'fair and equitable treatment' and 'full protection and security' do not require treatment in addition to or beyond that which is required by that standard, and do not create additional substantive rights. The obligation in paragraph 1 to provide: (a) 'fair and equitable treatment' includes the obligation not to deny justice in criminal, civil, or administrative adjudicatory proceedings in accordance with the principle of due process of law; and...

Similar provisions see also Article 9.6 (2) (a) of TPP (2016); Article 11.5 (2) of Australia- Korea FTA (2012), Article 5 (2) (a) of Japan-Ukraine BIT (2015), Article 4 (4) (5) of Colombia-Turkey BIT (2014), Article 11.5 (2) (a) of Australia-Korea FTA (2014), Article 10 (2) (a) of New Zealand-Taiwan Economic Cooperation Agreement, Article 8.5 (2) (a) of Korea-Colombia FTA (2013), Article 2 (2) (1) of Morocco-Viet Nam BIT (2012); etc.



- (a) denial of justice in criminal, civil or administrative proceedings;
- (b) fundamental breach of due process, including a fundamental breach of transparency, in judicial and administrative proceedings;
- (c) manifest arbitrariness;
- (d) targeted discrimination on manifestly wrongful grounds, such as gender, race or religious belief;
- (e) abusive treatment of investors, such as coercion, duress and harassment;
- or
- (f) a breach of any further elements of the fair and equitable treatment obligation adopted by the Parties in accordance with paragraph 3 of this Article.<sup>95</sup>

A similar approach to specifying FET obligations may be accepted in the future EU-Singapore FTA and the TTIP.<sup>96</sup>

The above new trend of FET provisions may limit the scope of FET obligations to some extent and guide future arbitral tribunals in assessing whether the host states have breached FET. As will be discussed later, these textual elements of FET overlap with components considered by tribunals in the interpretation and application of FET. Nevertheless, it remains to be seen how arbitral tribunals will apply these elements of FET to SOE protection in individual disputes. What is clear now is that SOE investments are generally granted FET protection under IIAs. But, the abstract and varied wordings adopted in different treaties suggest that to ascertain whether SOE investments are accorded FET remains a challenge.

#### 4.3.2 SOE Investments and Emerging Components of FET Obligations

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<sup>95</sup> Article 8.10 (2) of the CETA. Paragraph 3 of this Article provides that ‘the Parties shall regularly, or upon request of a Party, review the content of the obligation to provide fair and equitable treatment. The Committee on Services and Investment, established under Article 26.2.1(b) (Specialised committees), may develop recommendations in this regard and submit them to the CETA Joint Committee for decision’. According, the elements of FET are not limited to the listed obligations.

<sup>96</sup> See Article 9.4 (2) of the Draft EU-Singapore FTA (Version May 2015)

<[http://trade.ec.europa.eu/doclib/docs/2014/october/tradoc\\_152844.pdf](http://trade.ec.europa.eu/doclib/docs/2014/october/tradoc_152844.pdf)> accessed 12 September 2017; Article 3 (2) of the European Commission draft text TTIP

<[http://trade.ec.europa.eu/doclib/docs/2015/september/tradoc\\_153807.pdf](http://trade.ec.europa.eu/doclib/docs/2015/september/tradoc_153807.pdf)> accessed 4 Sep 2017.

As mentioned, arbitral tribunals have played a major role in the interpretation and application of FET. A range of components has been identified by tribunals that are comprised in the FET standard.<sup>97</sup> This part focuses on three factors concerned by tribunals in interpreting the FET standard, including unreasonable discrimination, legitimate expectation and arbitrariness, to discuss their application to SOE investors and impacts on host states.

#### *A. Unreasonable discrimination*

Some tribunals have held that the FET standard prohibits discriminatory treatment of foreign investors and their investments.<sup>98</sup> In *CMS v. Argentina*, for example, the tribunal held that ‘any measure that might involve arbitrariness or discrimination is in itself contrary to the FET’.<sup>99</sup> Earlier NAFTA tribunals have also included non-discrimination in the interpretation of the FET standard.<sup>100</sup> As the *Waste Management v. Mexico* tribunal stated, ‘the minimum standard of treatment of FET is infringed by conduct attributable to the State and harmful to the claimant if the conduct is arbitrary, grossly unfair, unjust or idiosyncratic, discriminatory’.<sup>101</sup> Hence, the FET standard inherently precludes discriminatory action against investors.<sup>102</sup>

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<sup>97</sup> The factors include: (a) legitimate expectation; (2) denial of justice and due process; (3) manifest arbitrariness; (d) discrimination; (e) outright abusive treatment. Some other elements such as transparency and consistency have generated concerns and criticism, so they may not be said to have materialised in the content of FET with a sufficient degree of support, UNCTAD, *Fair and Equitable Treatment* (n 75) 62–3. It is notable that scholars present different taxonomies of elements of the FET standard for understanding arbitral decisions in applying FET, Bonnitcha, Poulsen and Waibel (n 74) 109.

<sup>98</sup> UNCTAD, *Fair and Equitable Treatment* (n 75) 81.

<sup>99</sup> *CMS Gas Transmission Company v. The Republic of Argentina*, ICSID Case No. ARB/01/8, Award, 12 May 2005, paras 287, 290. See also *Saluka* (n 60), para 461; *Loewen Group, Inc. and Raymond L. Loewen v. United States of America*, ICSID Case No. ARB(AF)/98/3, Award on Merits, 26 June 2003, para 123; *Waste Management, Inc. v. Mexico*, ICSID Case No. ARB(AF)/00/3, Award, 30 April 2004, para 98.

<sup>100</sup> Katia Yannaca-Small, ‘Fair and Equitable Treatment Standard: Recent Developments’ in August Reinisch (ed), *Standards of Investment Protection* (OUP 2008) 122.

<sup>101</sup> *Water Management* (n 99), para 98.

<sup>102</sup> As Vasciannie explains, ‘...if there is discrimination on arbitrary grounds, or if the investment has been subject to arbitrary or capricious treatment by the host State, then the fair and equitable standard has been violated. This follows from the idea that fair and equitable treatment inherently precludes arbitrary and capricious actions against investors...’ Vasciannie (n 91) 133. See also Christoph H Schreuer, ‘Fair and Equitable Treatment (FET): Interactions with Other Standards’ (2007) 4 TDM 4–5 <[www.transnational-dispute-management.com/article.asp?key=1138](http://www.transnational-dispute-management.com/article.asp?key=1138)> accessed 12 September 2017.

Unlike NT and MFN, a discriminatory measure that breaches the FET standard is not necessarily taken on the basis of nationality.<sup>103</sup> Other considerations for discrimination such as race, religion, political affiliation, or disability may also form a violation of FET.<sup>104</sup> In this sense, the FET standard may fill gaps in the non-discrimination principle in IIAs since NT and MFN treatment can only guarantee non-discriminatory treatment on the basis of nationality.

However, a question arises whether a discriminatory measure taken on the basis of ownership breaches FET. In *Grand River Enterprises v. US*, the tribunal held that, ‘neither Article 1105 nor the customary international law standard of protection generally prohibits discrimination against foreign investments’.<sup>105</sup> In fact, arbitral tribunals seem to consider that only unreasonable discriminations constitute a violation of the FET standard. In other words, the host state may take discriminatory measures against foreign investors, as long as the action is made on reasonable considerations which normally refer to legitimate policy objectives. In *Saluka v. Czech Republic*, the tribunal held that:

[T]he standard of ‘reasonableness’ therefore requires, in this context as well, a showing that the State’s conduct bears a reasonable relationship to some rational policy, whereas the standard of ‘non-discrimination’ requires a rational justification of any differential treatment of a foreign investor.<sup>106</sup>

Despite that the tribunal’s interpretation may vary in individual disputes, arbitral practice has indicated that discriminatory treatment against foreign SOEs may not violate the FET standard if the host state action is driven by legitimate policy concerns.

The following question, therefore, is what are ‘legitimate policy concerns’ and to what extent the policy is ‘rational’ in respect of SOE investments. It is necessary here to address two observations in arbitral practice. First, public policy should not be motivated by purely political or discriminatory considerations. For example, the

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<sup>103</sup> Dlozer and Schreuer (n 10) 195.

<sup>104</sup> *ibid.*

<sup>105</sup> *Grand River Enterprises Six Nations, Ltd., et al. v. United States of America*, UNCITRAL, Award, 12 January 2011, para 209.

<sup>106</sup> *Saluka* (n 60), para 460.

*Saluka* tribunal held that a purely arbitrary act is one not related to legitimate policy objectives, and unreasonable conduct is motivated by political or discriminatory considerations. Similarly, the *S.D. Myers* tribunal considered that unreasonable acts were arbitrary acts or acts on the basis of political or discriminatory motives.<sup>107</sup> In this sense, host states' action against foreign SOEs is likely to be alleged by SOE investors for pursuing political or discriminatory motives. Nonetheless, it is not always easy for SOE investors to discern the intention of states' policies as the policy regarding SOEs may be driven by both commercial and political motivations.<sup>108</sup>

Second, domestic law can play a role in assessment. In *ADF v. US*, for instance, the tribunal noted that 'something more than simple illegality or lack of authority under the domestic law of State is necessary to render an act or measures inconsistent with FET'.<sup>109</sup> In *Noble Venture v. Romania*, the tribunal observed that the process of privatisation was not arbitrary given it was the only solution to the company's insolvency and was conducted in accordance with Romanian law.<sup>110</sup> However, some scholars argue that international tribunals should not rely on domestic law, given that it may not restrict certain discriminations. Nevertheless, domestic law can serve as an explicit expression of public policy. In other words, if a policy is expressed in domestic law, it is more likely to be interpreted as a rational policy.

As noted in previous chapters, some countries have taken measures against foreign SOEs in response to growing concerns about national security and competitive neutrality. In this context, regulatory measures against SOEs may come under scrutiny by arbitral tribunals for being discriminatory.<sup>111</sup> For instance, the UK government in 1988 directed KIO, a Kuwait SWF, to divest its stake within a year for the protection of the public interest.<sup>112</sup> In such a case, the KIO might claim that

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<sup>107</sup> *S.D. Myers* (n 43), para 263.

<sup>108</sup> See Ch 1.

<sup>109</sup> *ADF* (n 65), para 190.

<sup>110</sup> *Noble Ventures* (n 65), para 182.

<sup>111</sup> Poulsen (n 71) 89.

<sup>112</sup> Reuters, 'British Tell Kuwait to Cut BP Stake: Arab Oil Producer Could Lose \$593 Million in Selloff' *Los Angeles Times* (London, 5 October 1988) <[http://articles.latimes.com/1988-10-05/business/fi-2758\\_1\\_arab-oil](http://articles.latimes.com/1988-10-05/business/fi-2758_1_arab-oil)> accessed 17 March 2017. See also Chester Brown and Audley Sheppard, 'United Kingdom' in Chester Brown

divestment by the UK government breached the FET standard and an international tribunal would determine the issue. Here, while protecting public interest sounds like a rational policy, if UK legislation did not specify the divestment measures, the tribunal might consider that divestment breached FET as it constituted an unreasonable discrimination against KIO.

### *B. Legitimate expectations*

Many arbitral tribunals have recognised that the protection of investors' legitimate expectations is a key element of the FET standard under investment treaties.<sup>113</sup> In *Saluka v Czech Republic*, for example, the tribunal referred to the concept of legitimate expectations as 'the dominant element of that [FET] standard'.<sup>114</sup> The *Tecmed* tribunal also considered that the FET required states to provide international investment treatment that did not affect the 'basic expectations that were taken into account by the foreign investor to make the investment'.<sup>115</sup> Nonetheless, the legitimate expectation of foreign investors protected under the FET is a subject of disagreement and uncertainty among investment tribunals.<sup>116</sup>

Before we start to discuss the legitimate expectations of SOE investors protected by investment treaties, the question may arise of whether or not SOE investors differ from private investors in respect of legitimate expectations that would be protected by IIAs. In other words, whether SOE investors have legitimate expectations in international investments and if yes, are they different from that of private investors? As noted, the concept of legitimate expectations has been recognised in both domestic legal system and international law, without reference to the ownership of investors.<sup>117</sup> The doctrine of legitimate expectations may be formulated to offer an

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(ed), *Commentaries on Selected Model Investment Treaties* (OUP 2013) 742.

<sup>113</sup> UNCTAD, *Fair and Equitable Treatment* (n 75) 63.

<sup>114</sup> *Saluka* (n 60), para 302. Similarly, the *EDF* tribunal views the FET standard as 'one of the major components', *EDF (Services) Limited v. Romania*, Award, para 216.

<sup>115</sup> *Técnicas Medioambientales Tecmed, S.A. v. The United Mexican States*, ICSID Case No. ARB (AF)/00/2, Award, 29 May 2003, para 154.

<sup>116</sup> Bonnitche, Poulsen and Waibel (n 74) 111; Michele Potesta, 'Legitimate Expectations in Investment Treaty Law: Understanding the Roots and the Limits of a Controversial Concept' (2013) 28 ICSID Review 88, 89.

<sup>117</sup> Roland Klager, 'Fair and Equitable Treatment' in *International Investment Law* (CUP 2011) 165. More discussion on legitimate expectations in domestic legal systems see e.g., Potesta (n 116) 93–8.

individual ‘legal protections from harm caused by a public authority resiling from a previous publicly stated position, whether that be in the form of a formal decision or in the form of a representation’.<sup>118</sup>

Accordingly, the idea of legitimate expectations includes two aspects: one relates to the protection of the reliance of individuals on public authorities, and the other is to restrict willful revocation by those authorities.<sup>119</sup> As noted by some tribunals, investment treaties normally require host states to ensure a stable and predictable business environment for investors to operate investment.<sup>120</sup> In this regard, there should not be any difference between public and private investors. In *Tecmed v. Mexico*, the tribunal pointed out that:

[T]he foreign investor expects the host State to act in a consistent manner, free from ambiguity and totally transparently in its relations with the foreign investor, so that it may know beforehand any and all rules and regulations that will govern its investments, as well as the goals of the relevant policies and administrative practices or directives, to be able to plan its investment and comply with such regulations... the foreign investor also expects the host State to act consistently, i.e., without arbitrarily revoking any pre-existing decisions or permits issued by the State that was relied upon by the investor to assume its commitments as well as to plan and launch its commercial and business activities. The investor also expects the State to use the legal instruments that govern the actions of the investor or the investment in conformity with the function usually assigned to such instruments and not to deprive the investor of its investment without the required compensation...<sup>121</sup>

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<sup>118</sup> Chester Brown, ‘The Protection of Legitimate Expectations As A “General Principle of Law”’: Some Preliminary Thoughts’ (2009) 6 TDM 2 <[www.transnational-dispute-management.com/article.asp?key=1303](http://www.transnational-dispute-management.com/article.asp?key=1303)> accessed 12 September 2017.

<sup>119</sup> Klager (n 117) 165.

<sup>120</sup> *ibid* 169; Zach Meyers, ‘Adapting Legitimate Expectations to International Investment Law: A Defence of Arbitral Tribunals’ Approach’ (2014) 11 TDM 19; Benedict Kingsbury and Stephan Schill, ‘Investor-State Arbitration as Governance: Fair and Equitable Treatment, Proportionality and the Emerging Global Administrative Law’ (2009) New York University Public Law and Legal Theory Working Papers 141, 10 <[http://lsr.nellco.org/cgi/viewcontent.cgi?article=1146&context=nyu\\_plltwp](http://lsr.nellco.org/cgi/viewcontent.cgi?article=1146&context=nyu_plltwp)> accessed 12 September 2017.

<sup>121</sup> *Tecmed* (n 115), para 154.

While some scholars argue that the above expectations are too perfect to achieve,<sup>122</sup> they are common aspirations of all foreign investors, regardless of whether they are publicly- or privately-owned. Furthermore, SOE investors may have a greater demand for stability and predictability of an investment environment compared to private investors since some host states have given rise to increasing concerns over SOE investment and attempted to take measures against them.<sup>123</sup>

Nonetheless, not all expectations of SOE investors are legitimate and protected accordingly by international investment treaties. As the *EDF* tribunal stated, ‘legitimate expectations cannot be solely the subjective expectations of the investor’.<sup>124</sup> The *Suez* tribunal also noted that ‘expectations are protected only if they are legitimate and reasonable in the circumstances’.<sup>125</sup> Although tribunals differ in deciding whether an investor’s expectations are legitimate or not, some tribunals have recognised that investors’ legitimate expectations are based on the host state’s legal framework and any undertakings and representations made explicitly or implicitly by the host state.<sup>126</sup> In *Parkerings v. Lithuania*, for instance, the tribunal held that:

[T]he expectation is legitimate if the investor received an explicit promise or guarantee from the host state, or if implicitly, the host state made assurances or representation that the investor took into account in making the investment...in the situation where the host State made no assurance or representation, the circumstances surrounding the conclusion of the agreement are decisive to determine if the expectation of the investor was legitimate.<sup>127</sup>

<sup>122</sup> For example, Douglas argues that ‘the Tecmed standard is actually not a standard at all; it is rather a description of perfect public regulation in a perfect world, to which all states should aspire but very few if any will ever attain’, Zachary Douglas, ‘Nothing If Not Critical for Investment Treaty Arbitration: Occidental, Eureko and Methanex’ (2006) 22 *Arbitration international* 27, 28. Also, the *El Paso v. Argentina* tribunal held that Tecmed’s analysis of FET established ‘a programme of good governance that no state in the world is capable of guaranteeing at all times’, *El Paso Energy International Company v. The Argentine Republic*, ICSID Case No. ARB/03/15, Award, 31 October 2011, para 342.

<sup>123</sup> See Ch 1 and Ch 3.

<sup>124</sup> *EDF* (n 114), para 219.

<sup>125</sup> *Suez, Sociedad General de Aguas de Barcelona, S.A. and Vivendi Universal, S.A. v. Argentine Republic*, ICSID Case No. ARB/03/19, Decision on Liability, 30 July 2010, para 229.

<sup>126</sup> *Dlozer and Schreuer* (n 10) 145.

<sup>127</sup> *Parkerings-Compagniet AS v. Republic of Lithuania*, ICSID Case No. ARB/05/8, Award, 11 September 2007,

Similarly, in *Urbaser v. Argentina*, the tribunal acknowledge that a state's violation of specific commitments would breach FET where those commitments were 'decisive for an investor's decision to proceed with the investment'.<sup>128</sup> Nonetheless, tribunals may differ in what is a specific commitment. For example, in the *LG&E* case, the tribunal considered that the licensing of foreign investors constituted a specific commitment which had specifically guaranteed the payment of gas tariffs to investors in US dollars and indexed to the US gas market.<sup>129</sup> In *Charanne v Spain*, the tribunal held that the Spanish legislative framework in the solar sector did not create a specific commitment for each solar investor.<sup>130</sup> Obviously, the requirement of specific commitment limits the investor's legitimate expectations, which may prevent both private and SOE investors from claiming a breach of FET.

A relevant notion here is the stability of legal framework in the host state. This addresses the question of whether or not, where there is no specific commitment, the investor can have a legitimate expectation of a stable legal environment in the host state.<sup>131</sup> This issue is of great importance to SOE investors since an increasing number of states have strengthened or attempt to strengthen domestic regulations on SOEs.<sup>132</sup> Some scholars consider that the host state's legal framework is an important source of expectations for investors.<sup>133</sup> But, some tribunals criticised the view that FET entails a guarantee of stability of the legal framework unless the state has made specific commitments.<sup>134</sup> As the *Parkerings* tribunal stated:

[I]t is each State's undeniable right and privilege to exercise its sovereign legislative power. A State has the right to enact, modify or cancel a law at its

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para 331. See also *Waste Management* (n 99), paras 114-5; *Tecmed* (n 115), paras 152-74; *CMS* (n 99), para 290.

<sup>128</sup> *Urbaser S.A. and Consorcio de Aguas Bilbao Bizkaia, Bilbao Biskaia Ur Partzuergoa v. The Argentine Republic*, ICSID Case No. ARB/07/26, Award, 8 December 2016, para 627.

<sup>129</sup> *LG&E Energy Corp., LG&E Capital Corp., and LG&E International, Inc. v. Argentine Republic*, ICSID Case No. ARB/02/1, Decision on Liability, 3 October 2006, para 134.

<sup>130</sup> *Charanne and Construction Investments v. Spain*, SCC Case No. V 062/2012, Award (Unofficial English translation by Mena Chambers), 21 January 2016, paras 492-4.

<sup>131</sup> *Bonnitcha, Poulsen and Waibel* (n 74) 112.

<sup>132</sup> See more in Ch 1.

<sup>133</sup> *Dlozer and Schreuer* (n 10) 115. See e.g., *Occidental Petroleum Corporation and Occidental Exploration and Production Company v. The Republic of Ecuador*, ICSID Case No. ARB/06/11, Award, 5 October 2012, para 383.

<sup>134</sup> *LG&E* (n 129), Award, 25 July 2007, paras 66-7; *Suez, Sociedad General de Aguas de Barcelona, S.A. and Interagua Servicios Integrales de Agua, S.A. v. Argentine Republic*, ICSID Case No. ARB/03/17, Decision on Liability, 30 July 2010, para 224.



own discretion...Save for the existence of an agreement, in the form of a stabilisation clause or otherwise, there is nothing objectionable about the amendment brought to the regulatory framework existing at the time an investor made its investment.<sup>135</sup>

Similarly, the *Total v. Argentina* tribunal also noted that the legal regime in force in the host country at the time of making the investment ‘is not automatically subject to a guarantee of stability’, unless the host state has ‘explicitly’ assumed a specific legal obligation for the future, such as through contracts, concessions or stabilisation clauses on which the investor is therefore entitled to rely as a matter of law.<sup>136</sup> Nonetheless, some tribunals consider that in certain circumstances the change of legal framework may breach FET. For example, the *Toto* tribunal held that ‘changes in the regulatory framework would be considered as a breach of the duty to grant full protection and FET only in case of drastic or discriminatory changes in the essential features of the transaction’.<sup>137</sup> The *Impregilo* tribunal considered that ‘investors must be protected from unreasonable modifications of that legal framework’.<sup>138</sup> Accordingly, SOEs may allege that the host state violates FET if the change of legal framework is unreasonable or drastic. In *Tatneft v. Ukraine*, the tribunal held that ‘a predictable, consistent and stable legal framework is an FET requirement which ought to be safeguarded in this integrity irrespective of which organ of the State might compromise its availability’. Hence, both executive acts and acts of judiciary could frustrate the investor’s legitimate expectations of the host state.<sup>139</sup>

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<sup>135</sup> *Parkerings* (n 127), para 332.

<sup>136</sup> *Total S.A. v. The Argentine Republic*, ICSID Case No. ARB/04/01, Decision on Liability, 27 December 2010, para 117. The similar position can be found in *EDF* case, *EDF* (n 114), para 217; *El Paso* (n 122), para 364; *BG Group Plc. v. The Republic of Argentina*, UNCITRAL, Final Award, 24 December 2007, paras 292-310; *Plama Consortium Limited v. Republic of Bulgaria*, ICSID Case No. ARB/03/24, Award, 27 August 2008, para 219; *Continental Casualty Company v. The Argentine Republic*, ICSID Case No. ARB/03/9, Award, 5 September 2008, paras 258-61; *AES Summit Generation Limited and AES-Tisza Erőmű Kft v. The Republic of Hungary*, ICSID Case No. ARB/07/22, Award, 23 September 2010, paras 9.3.37-35; *Sergei Paushok, CJSC Golden East Company and CJSC Vostokneftegaz Company v. The Government of Mongolia*, UNCITRAL, Award on Jurisdiction and Liability, 28 April 2011, para 302; *Impregilo S.p.A. v. Argentine Republic*, ICSID Case No. ARB/07/17, Award, 21 June 2011, paras 290-1; *El Paso* (n 122), paras 344-52, 365-74.

<sup>137</sup> *Toto Costruzioni Generali S.p.A. v. The Republic of Lebanon*, ICSID Case No. ARB/07/12, Award, 7 June 2012, para 244.

<sup>138</sup> *Impregiolo* (n 136), para 291.

<sup>139</sup> *OAo Tatneft v. Ukraine*, UNCITRAL, Award on the Merits, 29 July 2014, para 407.

While the protection of legitimate expectations is an obligation of host states, some tribunals also take into account the conduct of investors. In this context, the SOE investor may be required to act diligently or prudently in taking into account all circumstances surrounding investment when making an investment. First, some cases have shown that investors must anticipate that circumstances could change and thus review their investment to adapt it to potential changes of legal environment. As the tribunal in *Parkerings v. Lithuania* stated, ‘the investor will have a right to protection of its legitimate expectations provided it exercised due diligence and that its legitimate expectations were reasonable in light of the circumstances’.<sup>140</sup> Second, some tribunals held that the regulatory risk should also be assessed in the context of legitimate expectations.<sup>141</sup> Third, investors should be aware and take into account the level of the country’s development and administrative practices.<sup>142</sup> The investor’s legitimate expectations must relate to the specific characteristics of the investment environment in the host state, given that the investor’s legitimate expectations would be quite different in the context of a highly developed country compared with a developing or emerging country.<sup>143</sup> One treaty, the COMESA, provides that the different levels of development of member states should be considered in the interpretation of the FET standard.<sup>144</sup>

In the absence of such an express provision in the treaty, tribunals have stressed that ‘the assessment of the reasonableness or legitimacy must take into account all circumstances, including not only the facts surrounding the investment but also the political, socioeconomic, cultural and historical conditions prevailing in the host State’.<sup>145</sup> In *MTD v. Chile*, the tribunal held that if the investor had performed a

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<sup>140</sup> *Parkerings* (n 127), para 333.

<sup>141</sup> *Methanex* (n 49), paras 9-10; *Glamis Gold, Ltd. v. The United States of America*, UNCITRAL, Award, 8 June 2009, para 767.

<sup>142</sup> UNCTAD, *Fair and Equitable Treatment* (n 75) 71.

<sup>143</sup> *Potesta* (n 116) 118.

<sup>144</sup> Article 14 (3) of Investment Agreement for the COMESA Common Investment Area (2007) provides that:  
[F]or greater certainty, Member States understand that different Member States have different forms of administrative, legislative and judicial systems and that Member States at different levels of development may not achieve the same standards at the same time. Paragraphs 1 and 2 of this Article [prohibition of the denial of justice and affirmation of the minimum standard of treatment of aliens] do not establish a single international standard in this context.

<sup>145</sup> *Duke Energy Electroquil Partners & Electroquil S.A. v. Republic of Ecuador*, ICSID Case No. ARB/04/19, Award, 18 August 2008, para 340.

diligent inquiry into the regulatory framework, it could not have developed legitimate expectations in the first place because its investigation would have evinced that its investment could not proceed as planned.<sup>146</sup> The *Metalpar* tribunal observed that the investor is unlikely to legitimately expect that ‘their investments would not be subject to the ups and downs of the country in which they were made or that the crisis that could already be foreseen would not make it necessary to issue legal measures to cope with’.<sup>147</sup> In this context, it is particularly necessary for SOE investors to know the regulations and policies targeted at SOE investments before making the investment; otherwise, it may fail to establish any protection based on legitimate expectations. For example, if it is known or ought to be known that an SOE investment bears higher requirements or will be treated unfairly or in an unfriendly manner, the claim of legitimate expectations under such conditions could hardly convince the tribunal.

Nevertheless, the relevant investment regulations in host states need to be accessible and transparent, and the requirement of transparency will promote the rule of law and better governance in host states. Yet, the *Urbaser v. Argentina* tribunal also pointed out that while FET required transparency, this does not mean that the host state has to ‘act under complete disclosure of any aspect of its operation’; rather, it means the state’s authorities shall act in such a way as to create a ‘climate of cooperation’ with investors when changes occurred.<sup>148</sup> Besides, the *Azinian* tribunal considered that if investors misrepresent or conceal their nature or purpose, they are not protected under the Treaty.<sup>149</sup> In this regard, SOE investments may be subjected to a higher requirement of transparency given that they are distrusted on suspicion of non-commercial motives, and SOE investments may fail to gain protection if they do not make required disclosures.

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<sup>146</sup> *MTD Equity Sdn. Bhd. and MTD Chile S.A. v. Republic of Chile*, ICSID Case No. ARB/01/7, Award, 25 May 2004, paras 167-178, 242-6.

<sup>147</sup> *Metalpar S.A. and Buen Aire S.A. v. The Argentine Republic*, ICSID Case No. ARB/03/5, Award on the Merits, 6 June 2008, para 187.

<sup>148</sup> *Urbaser* (n 128), para 682. Jarrod Hepburn, ‘Analysis: Arbitrators in *Urbaser v Argentina* Water Dispute Deviate From Prior Impregilo Award on Necessity And Damages’ *IAReporter* (12 January 2017) <<http://tinyurl.com/z6ydfa8>> accessed 12 September 2017.

<sup>149</sup> *Robert Azinian, Kenneth Davitian, & Ellen Baca v. The United Mexican States*, ICSID Case No. ARB (AF)/97/2, Award, 1 November 1999, para 105.

The rationale behind the protection of legitimate expectations is to enable the foreign investor to make sensible investment decisions on the basis of the representations of the host state.<sup>150</sup> However, arbitral practice has shown that it might be hard for SOE investors to invoke legitimate expectations. On the one hand, since SOEs have given rise to increasing a broad range of concerns such as national security and transparency in some countries, the tribunal may address the due diligence that SOE investors shall reckon regarding possible changes of legal framework in host states. On the other hand, regulations targeting SOEs are likely to be justified under the FET standard.

In fact, a significant number of awards have emphasised the need to balance investor expectations against the legitimate regulatory goals of the host country. They suggest that the FET obligation does not prevent host states from acting in the public interest even if such acts adversely affect investments.<sup>151</sup> In *Eureko v Poland*, the tribunal held that a breach of basic expectations might not be a violation of FET if good reasons existed why the expectations of the investor could not be met.<sup>152</sup> In *Saluka v. Czech Republic*, the tribunal held that:

...[T]he host State's legitimate right to regulate domestic matter in the public interest must be taken into consideration as well...

The determination of a breach of [FET] therefore requires a weighing of the claimant's legitimate and reasonable expectations on the one hand and the respondent's legitimate regulatory interests on the other...

A foreign investor...may in any case properly expect that the Czech Republic implements its policies *bona fide* by conduct that is, as far as it affects the investors' investment, reasonably justifiable by public policies and that such conduct does not manifestly violate the requirements of consistency, transparency, even-handedness and non-discrimination...<sup>153</sup>

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<sup>150</sup> Christoph Schreuer and Ursula Kriebaum, 'At What Time Must Legitimate Expectations Exist?' in Jacques Werner and Arif Hyder Ali (eds), *A Liber Amicorum: Thomas Walde - Law Beyond Conventional Thought* (CMP Publishing 2009) 265.

<sup>151</sup> UNCTAD, *Fair and Equitable Treatment* (n 75) 73.

<sup>152</sup> *Eureko* (n 64), para 232. Similar position can be found in *Continental Casualty* (n 136), para 258; *Vivendi* (n 91), para.7.4.31; *EDF* (n 114) para 217.

<sup>153</sup> *Saluka* (n 60), paras 305-7.

Similarly, the *EDF* tribunal stated that, ‘legitimate expectations cannot be solely the subjective expectations of the investors...expectations may be deduced from all the circumstances of the case, due regard being paid to the host state’s power to regulate its economic life in the public interest’.<sup>154</sup> Given that public interest is a vague concept and can be broadly extended, it is possible for host states to allege that changes of legal framework targeting SOEs are made on the basis of public interest because the emerging regulations on SOEs are made on the basis of national security, anti-competitiveness, and transparency concerns, and thereby the frustrations of SOEs’ legitimate expectations can be justified in this regard.

Notably, some scholars maintain that legitimate expectations should not be overstressed. The legitimate expectation doctrine is best understood as referring to a situation where the security principle is breached by the host state’s conduct inconsistent with prior promises or assurances on which the investor relied, rather than as a complete theory of the FET standard.<sup>155</sup> However, it is undeniable that it has played an increasingly significant role in the interpretation of the FET standard. Given the ambiguity of relevant concepts and the inconsistency of arbitral practice, both SOE investors and host states should be very cautious about how they conduct business in the context of legitimate expectations.

Some recent treaties attempt to clarify legitimate expectations under the FET standard, while the approach differs among states. The CETA, for instance, stipulates that in applying the FET obligation, a tribunal may take into account ‘whether a Party made a specific representation to an investor to induce a covered investment, that created a legitimate expectation, and upon which the investor relied in deciding to make or maintain the covered investment, but that the Party subsequently frustrated’.<sup>156</sup> In contrast, the TPP asserts that ‘the mere fact that a Party takes or fails to take an action that may be inconsistent with an investor’s expectations’ does not constitute a breach of FET, ‘even if there is loss or damage to

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<sup>154</sup> *EDF* (n 114), para 219.

<sup>155</sup> Vandevelde, *Bilateral Investment Treaties: History, Policy, and Interpretation* (n 21) 235.

<sup>156</sup> Article 8.10 (4) of CETA. Similar provisions proposed by the EU in the EU-Singapore FTA negotiations, Article 9.4 (2) (e).

the covered investment as a result'.<sup>157</sup> Nonetheless, tribunals have great discretion on whether and to what extent an SOE investor can successfully allege that the host state breaches its legitimate expectations.

### *C. Arbitrary conduct*

As discussed, a state's conduct is not frozen under the FET standard of the investment treaty. However, such flexibility of regulatory sovereignty does not mean there is no limitation on the host state's conduct. In *Parkerings v. Lithuania*, for instance, the tribunal held that each state has an 'undeniable right and privilege' to exercise its sovereign legislative power and any businessman or investor knows that laws will evolve over time. The FET standard under investment treaties only prevents the state from acting 'unfairly, unreasonably or inequitably in the exercise of its legislative power'.<sup>158</sup> In fact, beyond legitimate expectations, several tribunals have emphasised that the prohibition of arbitrariness is part and parcel of the FET standard.<sup>159</sup> Arbitral conduct has been described as 'founded on prejudice or preference rather than on reason or fact'.<sup>160</sup> The *Lemire* tribunal stated that 'the underlying notion of arbitrariness is that prejudice, preference or bias is substituted for the rule of law'.<sup>161</sup> In this context, legitimate regulations are protected by the treaty, but the state's conduct in regulatory matters should be exercised fairly, reasonably or equitably. Otherwise it may constitute a breach of the FET standard. Accordingly, some tribunals and commentators have suggested that it is only when a change in state policy or regulation amounts to 'manifestly arbitrary conduct' or 'to abuse of state power' that a violation of fair and equitable treatment would occur.<sup>162</sup>

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<sup>157</sup> Article 9.6 (4) of TPP.

<sup>158</sup> *Parkerings* (n 127), para 332.

<sup>159</sup> UNCTAD, *Fair and Equitable Treatment* (n 75) 78.

<sup>160</sup> *Ronald S. Lauder v. The Czech Republic*, UNCITRAL, Final Award, Award, 3 September 2001, para 221; *Plama* (n 136), para 184.

<sup>161</sup> *Joseph Charles Lemire v. Ukraine*, ICSID Case No. ARB/06/18, Decision on Jurisdiction and Liability, 21 January 2010, para 385.

<sup>162</sup> Kalicki and Medeiros (n 5) 49; Francisco Orrego Vicuña, 'Regulatory Authority and Legitimate Expectations: Balancing the Rights of the State and the Individual under International Law in a Global Society' (2003) 5 International Law FORUM du droit international 188, 194.

Some tribunals have attempted to interpret what manifest conduct is. For example, the *S.D.Myers* tribunal stated that:

[A] breach of Article 1105 (FET) occurs only when it is shown that an investor has been treated in such an unjust or arbitrary manner that the treatment rises to the level that is unacceptable from the international perspective. That determination must be made in the light of the high measure of deference that international law generally extends to the right of domestic authorities to regulate matters within their own borders.<sup>163</sup>

In *Enron v. Argentina*, the tribunal noted that ‘a finding of arbitrariness requires that some important measure of impropriety is manifest’.<sup>164</sup> The *Saluka* tribunal held that an investor may in any case properly expect that the host state ‘implements its policies *bona fide* by conduct that is, as far as it affects the investors’ investment, reasonably justifiable by public policies and that such conduct does not manifestly violate the requirements of consistency, transparency, even-handedness and nondiscrimination’.<sup>165</sup> However, in the *Thunderbird* case, the tribunal held that ‘the threshold for finding a violation of the minimum standard of treatment still remains high’.<sup>166</sup> The tribunals concluded that:

[A]cts that would give rise to a breach of the minimum standard of treatment prescribed by the NAFTA and customary international law [are] those that, weighed against the given factual context, amount to a gross denial of justice or manifest arbitrariness falling below acceptable international standards.<sup>167</sup>

In *Waste Management*, the tribunal held that there was no evidence to support that ‘the City acted in a wholly arbitrary way or in a way that was grossly unfair’, given that the failure to pay could be explained by the financial crisis and was not motivated by any sectoral or local prejudice.<sup>168</sup>

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<sup>163</sup> *S.D.Myers* (n 43), para 263.

<sup>164</sup> *Enron Corporation and Ponderosa Assets, L.P. v. Argentine Republic*, ICSID Case No. ARB/01/3, Award, 22 May 2007, para 281.

<sup>165</sup> *Saluka* (n 60), para 307.

<sup>166</sup> *International Thunderbird Gaming Corporation v. The United Mexican States*, UNCITRAL, Arbitral Award, 26 January 2006, para 194.

<sup>167</sup> *ibid*, para 197.

<sup>168</sup> *Waste Management* (n 99), para 115.

The ambiguous concept and distinct test of ‘arbitrary conduct’ may give rise to considerable controversies in assessing the host state’s conduct against SOEs. For instance, some tribunals have noted that conduct motivated by political considerations (politics and nationalistic reasons) might constitute ‘arbitrary action’ which violates the FET.<sup>169</sup> In *Eureko v. Poland*, the claimant’s request for expanding interest in a state-owned insurance company in the process of being privatised, relying upon Poland’s commitment, which would enable the claimant to be a controller, was withdrawn by the state. The tribunal held that ‘it is abundantly clear that the claimant has been treated unfairly and inequitably by the Republic of Poland’.<sup>170</sup> The tribunal noted that the conduct of Poland was ‘not for cause but for purely arbitrary reasons linked to the interplay of Polish politics and nationalistic reasons of a discriminatory character’.<sup>171</sup> Although it is questionable whether other tribunals would accept the same approach, the interpretation of treatment standards might provide a hypothetical scenario where foreign SOEs could be similarly affected, given that sovereign investment with a politically sensitive character is likely to be targeted by domestic measures in host states. As noted, the rise of sovereign FDI has been met with growing concern by policy-makers in some host countries, especially developed countries.<sup>172</sup> The most important and prevalent concern over SOEs relates to adverse national security implications in sensitive or strategic industries.<sup>173</sup> As a response, some countries have instituted new policy measures touching upon inward FDI by SOEs with a strong national security focus.<sup>174</sup> Although domestic protection of critical industries on national security grounds is generally permitted through trade and investment agreements, economic protectionism is not, and the lack of a defined concept of ‘national security’ makes it difficult to distinguish legitimate national security concerns from protectionism or other considerations.<sup>175</sup> In this context, conduct on the basis of national security

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<sup>169</sup> See e.g., *Inmaris Perestroika* (n 64), para 303; *Eureko* (n 64), para 233; *Azurix* (n 64), para 340; *Biwater* (n 64), para 500; *Eastern Sugar B.V. (Netherlands) v. The Czech Republic*, SCC Case No. 088/2004, Partial Award, 27 March 2007, para 199; *Vivendi* (n 91), para 74.22.

<sup>170</sup> *Eureko* (n 64), para 231.

<sup>171</sup> *ibid*, para 233.

<sup>172</sup> Sauvants, Sachs and Wouter P.F. Schmit Jongbloed (n 30) 10.

<sup>173</sup> *ibid* 11.

<sup>174</sup> *ibid* 16.

<sup>175</sup> *ibid* 17.



considerations of a political character might be challenged by foreign SOEs as ‘arbitrary’.

Nevertheless, the range of legitimate policies is potentially very broad and not limited to oft-mentioned goals of environmental protection, public health or consumer protection. Accordingly, it is necessary to draw a distinction between arbitrary conduct and legitimate regulation in the context of SOE FET protection. Otherwise, national security might be used as a tool of arbitrary conduct to target SOEs.

#### 4.4 Concluding Remarks

This chapter discusses whether and to what extent SOE investors enjoy non-discriminatory treatment and FET granted by host states under investment treaties. As shown in section 4.2, SOEs and their investments are in principle protected by investment treaties with standards of non-discriminatory treatment including NT and MFN. However, such NDT of SOEs is subject to various qualifications and exceptions. This relates especially to new generation IIAs, which to a large extent have granted flexibility to host states to address their concerns over SOE investments, including national security and competitive neutrality. As will be elaborated in next chapter, some recent investment treaties have provided security exceptions to NDT that can be useful to address national security concerns over SOEs. Meanwhile, host states’ concerns on competitive neutrality of SOEs can be addressed through clarifying the ‘in like circumstances’ component of the NDT test and through the use of ‘public policy’ exceptions. Nonetheless, further clarifications of the key terms, such as an express reference to ownership considerations in the definition of ‘in like circumstances’ and explicit inclusion of the ‘competitive neutrality’ objective in public policy exception provisions, would be helpful for states to protect their public interests and retain certain regulatory space in response to SOE challenges without a breach of NDT under investment treaties.

As shown in section 4.3, host states shall grant FET to foreign investors and their investments, regardless of whether they are publicly or privately owned. However,

the degree of FET protections differs among countries: under some treaties, the FET of SOEs equals to the minimum treatment standard under customary international law; while under some treaties, the FET of SOEs is subject to certain substantive elements. Since the relevant terms in the FET standard are broad and ambiguous, arbitral tribunals play an important role in assessing whether a host state's action breaches FET obligations. Three factors of the FET standard are normally considered by tribunals that may affect states' regulations on foreign SOEs, including unreasonable discrimination, legitimate expectations and arbitrary conduct. While national security or competitive neutrality considerations may be deemed as rational public policies, arbitral tribunals may consider that the state's action against SOEs on that basis is driven by political or discriminatory motivations that reduce the reasonableness of public policy. In this regard, an explicit expression of those considerations in domestic laws may be helpful to strengthen legitimacy of public policies. Moreover, a frustration of legitimate expectations of SOE investors may violate the FET standard, but SOEs' legitimate expectations may be restricted to certain conditions, such as due diligence. Also, regulations targeted to SOEs may not breach FET standard, but a host state's conduct cannot be exercised arbitrarily.

In sum, substantive standards of treatment as core provisions in international investment treaties are subject to great disagreement and uncertainty in arbitral practice. Two overarching conclusions emerge. First, the broad and vague terms in substantive standards of investment protections imply that investors may challenge a wide range of state actions at international tribunals. More importantly, tribunals have great discretion in deciding whether a host state's action against foreign SOEs violates substantive obligations of NDT and FET. In response to such uncertainty and unpredictability in arbitration, some recent treaties have attempted to clarify key provisions. Secondly, features of SOEs, such as state ownership or competitive advantages obtained from their home governments, may generate new problems regarding the application scope of substantive standards of treatment. As noted earlier, in application of NDT to an SOE investor, a tricky question of comparisons may be raised when identifying 'like circumstances'. Also, SOEs may be presumed to have weak legitimate expectations under FET, because they are used to higher levels of screening and slightly more stringent national regulations. Therefore, policy-makers may have to consider whether or not to adjust relevant substantive

standards of treatment to SOEs considering the expanding jurisdictional scope of investment arbitrations of SOE investments.

Taken together, the evolution of investment treaty and arbitral practice on substantive standards of investment protection suggest that it is pressing for host states to rethink and re-evaluate their treatment to foreign investors, whether private or public, under international investment law. The current investment treaty standards were devised by developed countries and crystallised long before the spread of SOE investments where provisions such as FET protection do not differentiate between SOE and other investment. This may render problems and conflicts to a variety of host state legitimate regulations with the application of treaty obligations. The challenge is how to attract foreign investments by providing adequate guarantees and protections, whilst preserving regulatory rights of states under the international investment regime. With the rise of SOE investments from developing countries, developed countries today may have to adjust some treaty standards for safeguarding legitimate public policies.



## CHAPTER 5:

# SOE INVESTMENTS AND INVESTMENT TREATY EXCEPTIONS: SAFEGUARDING STATES' ESSENTIAL INTERESTS

### 5.1 Introduction

The changing landscape of investment policy in relation to SOE investments requires a proper balance to be struck between protecting foreign SOE investors and addressing regulatory rights of host states. While this thesis maintains that SOE investors and their investments should in principle be accorded substantive protections such as NDT and FET under IIAs, it also acknowledges that SOEs, rather than other foreign investors, are more likely to trigger national security concerns due to their close ties with home governments and the potential for political interference by the government. Furthermore, Chapter 3 noted that whether the investor is controlled by a foreign government is an important factor to be considered by host states in determining the effect of SOE investments on national security.

Recently, a remarkable trend is that an increasing number of governments have strengthened screening procedures on foreign investments and barred certain SOE transactions because of national security considerations.<sup>1</sup> Although it is, of course, a sovereign right of states to screen or block foreign SOE investments on national security grounds, such measures have been criticised as protectionism against certain foreign investors. For example, China's leading news agency Xinhua said that the Hinkley deal was unexpectedly placed under review because of 'some fictitious national security concerns' over Chinese SOE involvement, i.e., 'China-phobia'.<sup>2</sup>

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<sup>1</sup> Since 2006 at least eight developed, developing and transition economies have enacted legislation on foreign investment reviews on national security grounds (i.e. Canada (2009), China (2011 and 2015), Finland (2012), Germany (2009), Italy (2012), the Republic of Korea (2006), Poland (2015), and the Russian Federation (2008)), UNCTAD, *World Investment Report 2016 - Investment Nationality: Policy Challenges* 95. For more discuss see Ch 2.

<sup>2</sup> Liu Chang, 'Commentary: London's approval for nuclear plant project welcoming move' *Xinhua* (Beijing, 15 September 2016) <[http://news.xinhuanet.com/english/2016-09/15/c\\_135689586.htm](http://news.xinhuanet.com/english/2016-09/15/c_135689586.htm)> accessed 26 January 2017.

In the context of international law, the question then arises of whether and to what extent IIAs should allow the contracting states to take regulatory measures against foreign SOE investors in order to protect certain vital interests. In other words, if a host state takes action against a foreign SOE investment, will it violate any international obligations under the applicable investment treaty?

With this consideration in mind, many treaties contain one or more exceptions which may be invoked by host states to safeguard certain important national interests and maintain their ability to exercise authority in that area.<sup>3</sup> In treaty practice, some exceptions are drafted narrowly to exclude the application of a specific treaty provision, for example, the commitment to non-discriminatory treatment;<sup>4</sup> other treaties contain a carve-out exception to exclude the application of all treaty provisions.<sup>5</sup> In order to protect certain vital interests, some treaties explicitly allow contracting states to derogate from treaty obligation under exceptional circumstances where these vital interests are at stake.<sup>6</sup> Such vital interests include national security, public order, and international peace and security.<sup>7</sup> Some treaties also refer to public interest in the form of human, animal or plant life or health, public security or moral or public order, the conservation of finite natural resources, and so on.<sup>8</sup>

When some foreign investors filed cases against Argentina in response to the financial crisis, the Argentinian government, relying on provisions of this kind, argued that the emergency measures were taken to protect ‘essential security interests’ which could be justified under the US-Argentina BIT. Accordingly, if an SOE investor brings a case in an investment tribunal, the responding state is in theory likely to invoke such exception clauses to justify its action against SOE investments.

However, such a scenario relating to SOE investment has never been tested in a real

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<sup>3</sup> Jeswald W Salacuse, *The Law of Investment Treaties* (Second Edi, OUP 2015) 377.

<sup>4</sup> For further discussions see Ch 4.

<sup>5</sup> For example, Article 19 of the ASEAN Comprehensive Investment Agreement explicitly carves out a class of ‘investors’ from the protections under the treaty.

<sup>6</sup> Salacuse (n 3), 378.

<sup>7</sup> For example, Article XI of the US-Argentina BIT. *ibid.*

<sup>8</sup> For example, Article 28.3 (General exceptions) of the CETA.

arbitral case. Furthermore, treaty practice on the exception clause is diverse while arbitral interpretations are relatively few and not always consistent, leaving the question far from resolved.

It is in this context, therefore, that this chapter attempts to analyse whether, to what extent, and under what circumstances the host state can invoke treaty exceptions to justify its regulatory measures against SOE investments. The following discussion focuses on security exception clauses in IIAs and their invocations by host states to deal with security-related concerns over foreign SOE investments. The purpose of this chapter is to examine the significant role of security exception clauses in safeguarding states' essential interests in relation to its SOE investments and to outline implications for rule-makers who have to strike a proper balance between the protection of foreign SOE investments and that of the policy discretion of states.

## 5.2 Regulatory Measures for Foreign SOE Investments and Risk of Investor-State Arbitration

Before discussing whether a host state's regulatory measure against a foreign SOE investment may be justified by invoking treaty exceptions, we must ascertain whether the restrictive measure relates to the establishment of foreign SOE investments or to their treatments *after* establishment.<sup>9</sup> As noted in the previous chapters, most debates surrounding the national security implications of foreign SOE investments focus on screenings which result in the host states blocking certain transactions involving foreign SOEs for reasons of national security.<sup>10</sup> Restrictive measures of this kind usually relate to the market access of foreign SOE investments, especially to critical infrastructure and so-called 'strategic' industries.<sup>11</sup>

<sup>9</sup> UNCTAD, *World Investment Report 2009 - Transnational Corporations, Agricultural Production and Development* 27.

<sup>10</sup> For more discussion see Ch 2.

<sup>11</sup> Countries define 'critical infrastructure' or 'strategic industries' in various ways and, which mainly include mining of minerals, exploration of oil and gas, energy generation and transmission, water supply, telecommunication, IT, etc., see UNCTAD, *WIR 2016* (n 1) 97; Kathryn Gordon and Maeve Dion, 'Protection Of "Critical Infrastructure" And The Role Of Investment Policies Relating To National Security' (OECD Publishing 2008) 3–5 <<https://www.oecd.org/investment/investment-policy/40700392.pdf>> accessed 12 September 2017; Frédéric Wehrlé and Joachim Pohl, 'Investment Policies Related to National Security: A Survey of Country

However, it is noteworthy that in the post-entry phase host states may also impose restrictions on foreign investments, irrespective of whether they are publicly or privately owned, to protect some important national interest or policy. In the context of Argentina's 2011 financial crisis, for instance, the Argentinian government imposed a series of regulatory measures, including the control of capital transfer, in order to mitigate the worsening economic situation.<sup>12</sup>

There are also some cases in which host governments have adopted legislation in favour of strategic domestic industries like the energy sector, telecommunications or water supply; or in which host governments have cancelled licenses or state contracts, or even dispossessed a foreign investment either by closing it down or by forcing the investor to divest certain interests.<sup>13</sup> In the first *Vattenfall* case, for example, the Swedish state-owned energy company, Vattenfall, claimed that the German government changed their prior agreement and imposed additional environmental restrictions on its power plant project under construction.<sup>14</sup> In the second *Vattenfall* dispute, shortly after the Fukushima nuclear disaster in Japan, the German parliament amended its Atomic Energy Act to phase out nuclear energy, resulting in an immediate closure of Vattenfall's nuclear power plants.<sup>15</sup> Although such national regulations do not target SOE investments specifically, they may significantly affect any established foreign investments including those involving with SOEs, which are

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Practices' (OECD Publishing 2016) 2016/02 22–4 <<http://dx.doi.org/10.1787/5jlwrrf038nx-en>> accessed 12 September 2017.

<sup>12</sup> José E Alvarez and Tegan Brink, 'Revisiting the Necessity Defense: Continental Casualty v. Argentina' in Karl P Sauvart (ed), *Yearbook on International Investment Law & Policy 2010-2011* (OUP 2012) 322.

<sup>13</sup> UNCTAD, *The Protection of National Security in IIAs: UNCTAD Series on International Investment Policies for Development* (UN Publication 2009) 30–2; UNCTAD, *WIR 2016* (n 1) 97.

<sup>14</sup> The parties reached a settlement agreement before the tribunal could rule on any issue, Rudolf Dolzer and Yun-I Kim, 'Germany' in Chester Brown (ed), *Commentaries on Selected Model Investment Treaties* (OUP 2013) 300. For more discussion see also Nathalie Bernasconi, 'Background Paper on Vattenfall v. Germany Arbitration' (IISD 2009) <[https://www.iisd.org/pdf/2009/background\\_vattenfall\\_vs\\_germany.pdf](https://www.iisd.org/pdf/2009/background_vattenfall_vs_germany.pdf)> accessed 12 September 2017.

<sup>15</sup> Notably, this case is still pending. For more discussion see Nathalie Bernasconi-Osterwalder and Rhea Tamara Hoffman, 'The German Nuclear Phase-Out Put to the Test in International Investment Arbitration? Background to the New Dispute Vattenfall v Germany (II)' [2012] IISD Briefing Note <[http://www.iisd.org/pdf/2012/german\\_nuclear\\_phase\\_out.pdf](http://www.iisd.org/pdf/2012/german_nuclear_phase_out.pdf)> accessed 12 September 2017. Besides, some companies also filed cases in German court, and the Federal Constitutional Court has made a judgement on 6 December 2016, see 'The Thirteenth Amendment to the Atomic Energy Act Is for the Most Part Compatible with the Basic Law' (Press Release No. 88/2016, 6 December 2016) <<https://www.bundesverfassungsgericht.de/SharedDocs/Pressemitteilungen/EN/2016/bvg16-088.html>> accessed 12 September 2017. See also Ch 1.



likely challenged in future investment arbitrations.

Even if a host state has approved a transaction by foreign SOEs in a national security review, security-related concerns arising from SOE investment may resurface after its establishment, and the host state may then wish to take regulatory measures restricting or otherwise detrimentally affecting the SOE project. Returning to the instance of the Hinkley Point project, Nick Timothy, an advisor to the British Prime Minister Teresa May, once said in objection to the project that ‘Chinese could use their role to build weaknesses into computer systems which will allow them to shut down Britain's energy production at will...’<sup>16</sup> Although the deal was provisionally approved by Mrs May, it is possible for future British governments to take action against the Chinese SOE investor, CGN, and its investments in Hinkley and the other two nuclear power stations for national security interests. In such a hypothetical case, the British government may take various restrictive measures such as divestment or even nationalisation of the foreign SOE investment; it may also amend legislation to shut down the facilities (such as in the *Vattenfall II* case) or restrict financial transfers (such as in many Argentine cases).

It is notable that in 1988 the UK government directed an SWF, Kuwait Investment Office (KIO), to divest its 21.6% stake in British Petroleum (BP) to 9.9% within a year for the protection of the ‘public interest’.<sup>17</sup> While the KIO purchased the major stake in BP after its privatisation on the open market, the British Monopolies and Mergers Commission (BMMC) investigated the holding and noted that ‘unlike other shareholders, Kuwait is a sovereign state with wide strategic interests and could be expected to exercise its influence in support of its own national interest’.<sup>18</sup> This case provides a clear example that host state may revoke an SOE investment on the basis of a vaguely defined ‘public interest’, even if it is a completely legal transaction.<sup>19</sup>

<sup>16</sup> Henry Hill, ‘The wit and wisdom of Nick Timothy. 19) Stop selling our security to China’ *Conservative Home* (15 July 2016) <<http://www.conservativehome.com/parliament/2016/07/the-wit-and-wisdom-of-nick-timothy-19-stop-selling-our-security-to-china.html>> accessed 30 January 2017.

<sup>17</sup> Reuters, ‘British Tell Kuwait to Cut BP Stake: Arab Oil Producer Could Lose \$593 Million in Selloff’ *Los Angeles Times* (London, 5 October 1988) <[http://articles.latimes.com/1988-10-05/business/fi-2758\\_1\\_arab-oil](http://articles.latimes.com/1988-10-05/business/fi-2758_1_arab-oil)> accessed 29 March 2017; Brown and Sheppard 742.

<sup>18</sup> *ibid.*

<sup>19</sup> Christopher Balding, *Sovereign Wealth Funds: The New Intersection of Money and Politics* (OUP 2012) 84.

Whether the regulatory measure relates to the pre-entry or post-entry of foreign SOEs relates closely to whether the host state's action is subject to international investment obligations. In this context, the situation may be distinguished between investment treaties which only cover the post-establishment phase and those which extend to a pre-establishment phase. Specifically speaking, under IIAs that cover the pre-establishment phase, if the contracting state restricts the entry of foreign SOEs for national security considerations, state action might amount to a violation of relevant treaty commitments, such as non-discriminatory treatment, and SOE investors might challenge such state action in an investor-state arbitration, unless there are express reservation and exceptions.<sup>20</sup>

As mentioned earlier in Chapter 3, some treaties have expressly excluded certain sectors or activities relevant to national security or of strategic importance from pre-establishment obligations. A problem here is that the sector or activity as strategically important or sensitive for national security may change over time.<sup>21</sup> For instance, with the rapid developments of technologies, cyber security has become a critical element in national security interests and the IT industry may be considered as being strategically important. Hence, it seems impossible to exclude all sectors and activities relevant to national security or of strategic importance from pre-establishment commitments.

However, if a treaty providing for pre-establishment protection has included security-related exceptions, the host state can have recourse to the exception clause to defend entry restrictions and to become exempt from international obligations. For example, if the US government blocks a foreign SOE transaction in the CFIUS review, the SOE investor might claim that the CFIUS determination violates pre-establishment non-discriminatory treatment in an international arbitration. In such a case, some scholars argue that the security exception clause under the US 2012 Model BIT is 'broad enough' to allow the US regulators to protect essential security interests.<sup>22</sup> While this argument is disputable and has never been tested in practice,<sup>23</sup>

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<sup>20</sup> For more discussion see Ch 3.

<sup>21</sup> UNCTAD, *The Protection of National Security in IIAs* (n 13) 29.

<sup>22</sup> Chow 121.

<sup>23</sup> Lauren Gloudeman and Nargiza Salidjanova, 'Policy Considerations for Negotiating a US-China Bilateral

it at least suggests that the security exception clause can be used to safeguard important national interests of host states, including protecting host states' discretion to restrict the entry of foreign SOEs for national security considerations.<sup>24</sup>

By contrast, most international investment treaties do not cover the pre-establishment phase; thus, host states' actions in respect of the market access of foreign SOEs will never trigger a violation of treaty obligations.<sup>25</sup> Here, the IIA does not prevent contracting states from denying entry to certain foreign SOEs due to national security considerations. For example, under the current China-UK BIT,<sup>26</sup> the Chinese SOE investor would not be able to claim that the Hinkley Point review violated treaty obligations. This is because the China-UK BIT does not grant establishment rights, so the UK government retains unlimited discretion to control the entry of foreign investments.<sup>27</sup>

Some argue that imposing burdensome restrictions on FDI inflows could trigger other nations to enact similarly restrictive policies.<sup>28</sup> Meanwhile, blocking a foreign SOE investment might discourage other SOE investors and be suspected of creating an unwelcoming environment for foreign investments. To avoid this, some pre-establishment IIAs contain a political commitment to create favourable conditions for foreign investment from the other contracting state.<sup>29</sup> Some countries have in addition signed a nonbinding commitment to treat foreign SOEs on their territories no less favourably than domestic enterprises.<sup>30</sup> But under most IIAs that remain

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Investment Treaty' (Economic and Security Review Commission Staff Research Report 2016) 25  
<https://www.uscc.gov/Research/policy-considerations-negotiating-us-china-bilateral-investment-treaty>  
 accessed 12 September 2017.

<sup>24</sup> For more discussion see Ch 3.

<sup>25</sup> UNCTAD, *The Protection of National Security in IIAs* (n 13) 28.

<sup>26</sup> See the China-UK BIT (1986) <<http://investmentpolicyhub.unctad.org/Download/TreatyFile/793>> accessed 30 January 2017.

<sup>27</sup> For more see Ch 3.

<sup>28</sup> Jonathan Masters and James McBride, 'Foreign Investment and U.S. National Security' *Council on Foreign Relations* (14 December 2016) <<http://www.cfr.org/foreign-direct-investment/foreign-investment-us-national-security/p31477>> accessed 30 January 2017.

<sup>29</sup> UNCTAD, *The Protection of National Security in IIAs* (n 13) 28.

<sup>30</sup> OECD, 'Declaration on International Investment and Multinational Enterprises' (25 May 2011)  
 <<http://www.oecd.org/daf/inv/investment-policy/oecddeclarationoninternationalinvestmentandmultinationalenterprises.htm>> accessed 30 January 2017;  
 Masters and McBride (n 28).

completely silent on establishment rights, under no circumstances can even the most restrictive policy of a host state in respect of pre-establishment stipulations amount to a treaty obligation.<sup>31</sup>

The post-establishment IIAs, however, do not prevent SOE investors from alleging the violation of obligations such as non-discriminatory treatment, expropriation, compensation or transfers, if a host government has imposed restrictions in the post-establishment phase, just as in the hypothetical instance of Hinkley Point or the divestment order against KIO. In such scenarios, the outcome very much depends on the specific circumstances of the individual case, the precise language of that particular treaty, and the tribunal's interpretation.

### 5.3 Exception Clauses and Policy Discretion to Regulate SOE Investments

While the network of IIAs and the investor-state dispute settlement mechanism may entitle foreign investors to challenge the states' restrictive measures before arbitral tribunals, some treaties also contain exception clauses which can limit the applicability of investor protections in certain circumstances.<sup>32</sup> For example, Article XI of the US-Argentina BIT states:

This Treaty shall not preclude the application by either Party of measures necessary for the maintenance of public order, the fulfilment of its obligations with respect to the maintenance or restoration of international peace or security, or the protection of its own essential security interests.<sup>33</sup>

Thus this exception clause allows the contracting states to take actions otherwise inconsistent with the treaty for specific objectives including 'maintenance of public

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<sup>31</sup> UNCTAD, *The Protection of National Security in IIAs* (n 13) 28.

<sup>32</sup> William W Burke-White and Andreas von Staden, 'Investment Protection in Extraordinary Times : The Interpretation and Application of Non-Precluded Measures Provisions in Bilateral Investment Treaties' (2008) 48 *Virginia Journal of International Law* 309, 311; Salacuse (n 3) 378. Notably, as many treaty exceptions usually use the term 'preclude', such clauses also refer to non-precluded measure clauses (NPM clauses). Since the NPM may give rise to a confusion between treaty-based NPM clause and necessity defence in customary international law, for purpose of this research, the term of 'exception clause' will be adopted.

<sup>33</sup> Article XI of the US-Argentina BIT.

order’, ‘maintenance or restoration of international peace or security’, and ‘protection of essential security interests’.<sup>34</sup> Such an exception clause implies that contracting states may take actions against foreign SOEs or SOE investments for the protection of certain interests where the actions do not constitute breaches of international commitments and the states should not face liability under the investment treaty.

Nonetheless, whether, to what extent, and under what circumstances a host state can take regulatory measures against a foreign SOE investment very much depend on the language of a specific exception clause. Hence, the policy discretion of host states to take restrictive measures against SOE investments may be different under different investment treaties. The principal issue is whether the host state’s action against a foreign SOE investment falls within the permissible objectives covered by the exception clause. The broader the range of permissible objectives, the greater the degree of flexibility retained by host states to regulate foreign SOE investments.<sup>35</sup>

The permissible objectives in exception clauses which are most frequently invoked are security,<sup>36</sup> international peace and security,<sup>37</sup> and public order.<sup>38</sup> Some treaties also allow contracting parties to pursue other objectives, such as public health,<sup>39</sup> public morality,<sup>40</sup> extreme emergency,<sup>41</sup> prevention of disease or pests,<sup>42</sup> the

<sup>34</sup> Burke-White and von Staden (n 32) 309; Salacuse (n 3) 311–2.

<sup>35</sup> Andrew D Mitchell and Caroline Henckels, ‘Variations on a Theme: Comparing the Concept of “Necessity” in International Investment Law and WTO Law’ (2013) 14 *Chicago Journal of International Law* 93, 105; Anne van Aaken, ‘International Investment Law between Commitment and Flexibility: A Contract Theory Analysis’ (2009) 12 *Journal of International Economic Law* 507, 523–4.

<sup>36</sup> See e.g., Article X (1) of the Panama-US BIT (1982); Article 1 of the Senegal-US BIT (1983); Article 11 of the China-Singapore BIT (1985); Article 11 of the China-New Zealand BIT (1988); Article X (1) of the Argentina-US BIT (1991); Article XIV of the Nicaragua-US BIT (1995) Article XIV; Article 15 of the Australia-India BIT (1999); Article 14 of the China-India BIT (2006); Article 10 (4) of the Canada-Peru BIT (2006); Article IX (5) of the Canada-Czech Republic BIT (2009); Article 18 of the China-Japan-Korea trilateral investment agreement (2012); Article 12.18 (1) of the Australia-Malaysia FTA (2012); Article 17 (4) of the Canada-Tanzania BIT (2013); Article 12.14 of the China-Korea FTA (2014); etc.

<sup>37</sup> See e.g., Article X (1) of the Panama-US BIT (1982); Article X (1) of the Argentina-US BIT (1991); Article XIV of the Nicaragua-US BIT (1995); Article IX (5) of the Canada-Czech Republic BIT (2009); Article 18 of the China-Japan-Korea trilateral investment agreement (2012); Article 12.14 of the China-Republic of Korea FTA (2014); etc.

<sup>38</sup> See e.g., Article X (1) of the Panama-US BIT (1982); Article 1 of the Senegal-US BIT (1983); Article X (1) of the Argentina-US BIT (1991); Article 14.15 (a) of the Australia-Japan EPA (2014); etc.

<sup>39</sup> See e.g., Article 11 of the China-Singapore BIT (1985); Article 11 of the China-New Zealand BIT (1988); etc.

<sup>40</sup> See e.g., Article 1 of the Senegal-US BIT (1983); Article 12.18 (1) of the Australia-Malaysia FTA (2012)

protection of human, animal or plant life or health,<sup>43</sup> conservation of natural resources,<sup>44</sup> prudential reasons,<sup>45</sup> protection of cultural industries,<sup>46</sup> sound development of national economy,<sup>47</sup> and so on.<sup>48</sup>

Moreover the exception clauses commonly include a nexus requirement which determines both the relationship between the disputed measure and permissible objectives and, consequentially, the degree of scrutiny that an investment tribunal would be expected to direct at the relationship between the policy objective and the measure chosen to achieve it.<sup>49</sup> Most of the exception clauses require that state action should be ‘necessary’ for the permissible objectives,<sup>50</sup> while other exception clauses define the nexus requirement that the measure must be ‘required’,<sup>51</sup> ‘directed to’,<sup>52</sup> ‘proportional to’,<sup>53</sup> ‘appropriate to’,<sup>54</sup> ‘for’,<sup>55</sup> or ‘designed or applied to’<sup>56</sup> the

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Article 14.15 (a) of the Australia-Japan EPA (2014); etc.

<sup>41</sup> See e.g., Article 14 of the China-India BIT (2006); Article 20 of the China-Japan-Korea TIA (2012); etc.

<sup>42</sup> See e.g., Article 11 of the China-Singapore BIT (1985); Article 11 of the China-New Zealand BIT (1988); Article 15 of the Australia-India BIT (1999); etc.

<sup>43</sup> See e.g., Article 10 (1) of the Canada-Peru BIT (2006); Article IX (1) of the Canada-Czech Republic BIT (2009); Article 12.18 (1) of the Australia-Malaysia FTA (2012); Article 17 (1) of the Canada-Tanzania BIT (2013); Article 14.15 (b) of the Australia-Japan EPA (2014); Article 9.8 of the China-Korea FTA (2015); etc.

<sup>44</sup> See e.g., Article 10 (1) of the Canada-Peru BIT (2006); Article IX (1) of the Canada-Czech Republic BIT (2009); Article 12.18 (1) of the Australia-Malaysia FTA (2012); Article 17 (1) of the Canada-Tanzania BIT (2013); Article 14.15 (e) of the Australia-Japan EPA (2014); Article 9.8 of the China-Republic of Korea FTA (2015); etc.

<sup>45</sup> See e.g., Article 10 (2) of the Canada-Peru BIT (2006); Article IX (2) of the Canada-Czech Republic BIT (2009); Article 17 (2) of the Canada-Tanzania BIT (2013); etc.

<sup>46</sup> See e.g., Article 10 (6) of the Canada-Peru BIT (2006); Article IX (7) of the Canada-Czech Republic BIT (2009); Article 12.18 (1) of the Australia-Malaysia FTA (2012); Article 17 (7) of the Canada-Tanzania BIT (2013); Article 14.15 (d) of the Australia-Japan EPA (2014); Article 9.8 of the China-Korea FTA (2015); etc.

<sup>47</sup> See e.g., the Protocol of the China-Japan BIT (1988) provides that:

3. ...it shall not be deemed “treatment less favorable” for either Contracting Party to accord discriminatory treatment, in accordance with its applicable laws and regulation, to nationals and companies of the other Contracting Party, in case it is really necessary for the reason of public order, national security or sound development of national economy.

<sup>48</sup> Burke-White and von Staden (n 32) 334–5; Mitchell and Henckels (n 35) 105–6.

<sup>49</sup> *ibid* 107.

<sup>50</sup> See e.g., Article 18 of the US 2012 Model BIT; Article 10 (1) & (4) of the Canada 2004 Model FIPA.

<sup>51</sup> See e.g., Article 3 (2) of the Belgium-Luxembourg-Uganda BIT.

<sup>52</sup> See e.g., Article 11 of the China-New Zealand BIT.

<sup>53</sup> See e.g., Article VIII of the Colombia 2007 Model BIT

<[http://www.italaw.com/documents/inv\\_model\\_bit\\_colombia.pdf](http://www.italaw.com/documents/inv_model_bit_colombia.pdf)> accessed 5 Feb 2017.

<sup>54</sup> See e.g., Article 22 (2) of the COMESA Investment Agreement <[http://www.tralac.org/wp-content/blogs.dir/12/files/2011/uploads/Investment\\_agreement\\_for\\_the\\_CCIA.pdf](http://www.tralac.org/wp-content/blogs.dir/12/files/2011/uploads/Investment_agreement_for_the_CCIA.pdf)> accessed 5 Feb 2017.

<sup>55</sup> See e.g., Article 12 (2) of the Croatia-India BIT (2001).

<sup>56</sup> See e.g., Article 22 (1) of the COMESA Investment Agreement.

protection of permissible objectives.<sup>57</sup> Whilst many exception clauses apply to the entire investment treaty,<sup>58</sup> other exception clauses apply only to specific provisions, such as expropriation,<sup>59</sup> non-discrimination,<sup>60</sup> dispute settlement,<sup>61</sup> applicable laws,<sup>62</sup> etc.<sup>63</sup> The applicability of exception clauses varies significantly between different treaties.

While foreign SOE investment may give rise to various concerns in host states, most of the current debates centre on those of national security.<sup>64</sup> In IIAs that include national security exceptions, states may choose to use different formulations of security exception clauses, reflecting a different level of discretion that contracting states wish to retain for themselves when faced with a security threat.<sup>65</sup> For example, some treaties include broad national security exceptions, by means of an independent national security exception clause or a general exception clause, that aim at maximum state discretion; other treaties adopt a narrower approach, by listing the invocation conditions or restricting the application to specific substantive provisions.<sup>66</sup> While only a few investment treaties contain national security exceptions, such provisions may become more important in future IIA negotiations, because national security has become an important part of foreign investment policies where there is a need for states to retain certain levels of discretion and flexibility in order to regulate foreign investments and to avoid international obligations.

Security exceptions formulated differently may have different implications for their interpretation in concrete cases. Many security exception clauses, for example,

<sup>57</sup> Mitchell and Henckels (n 35) 106–7; Burke-White and von Staden (n 32) 330–1.

<sup>58</sup> For example, the US– Panama BIT provides that ‘[t]his treaty shall not preclude...’ the Canadian 2004 Model FIPA provide that ‘nothing in this Agreement shall preclude...’ *ibid* 331.

<sup>59</sup> See e.g., Article 4 of the BLEU– China BIT (2005).

<sup>60</sup> See e.g., para 4 Ad Article 3 of the Protocol of the China–Germany BIT (2003); para 3 of the Protocol of the China–Japan BIT (1988).

<sup>61</sup> See e.g., Article 19 of the Austria–Mexico BIT (1998).

<sup>62</sup> See e.g., Article 11(2) of the India–UK BIT (1994).

<sup>63</sup> K Yannaca-Small, ‘Essential Security Interests under International Investment Law’, *International Investment Perspectives: Freedom of Investment in a Changing World* (OECD Publishing 2007) 99.

<sup>64</sup> See also Ch 1.

<sup>65</sup> UNCTAD, *The Protection of National Security in IIAs* (n 13) 71.

<sup>66</sup> *ibid*.

allude to ‘essential security interests’,<sup>67</sup> while others use the term ‘national security’,<sup>68</sup> or ‘public security’.<sup>69</sup> The question then may be asked whether these terms address the same kind of situations. One may argue that the terminology of ‘essential security interests’ seems narrower than that of ‘national security’ by including the expression ‘essential’; and ‘public security’ might be broader than ‘national security’, as ‘it may also cover scenarios where the security threat does not reach the national level but is limited to a local or regional event’.<sup>70</sup> A few treaties may define and clarify the relationship between the security-related terms used in exception clauses. Under the Canada-Korea FTA, for instance, ‘national security’ includes contracting parties’ ‘essential security interests’ and international peace and security,<sup>71</sup> while the COMESA Investment Agreement comprises both ‘national security’ and ‘essential security interests’ within the general exception clause.<sup>72</sup>

However, since most treaties only use the term ‘essential security interests’, a potential debate might arise concerning whether or not a restrictive measure against foreign SOEs, such as a negative national security review decision would fall within the scope of the essential security interests covered by the relevant exception clause. Some argue that ‘it is far from obvious that contracting parties, by choosing one of these alternatives, actually intended to introduce such a distinction... [which] leaves

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<sup>67</sup> See e.g., United States of America-Uruguay BIT (2005) Article 18; Rwanda-United States of America BIT (2008) Article 18; US 2012 Model BIT Article 18; etc.

<sup>68</sup> See e.g., Article 2 of the Protocol of the China-Korea BIT (1992); Canada-Korea FTA (2014) Article 22.2; CETA Article 28.6; Article 22 (1) (a) of the COMESA Investment Agreement.

<sup>69</sup> See e.g., Article 28.3 (2) (a) of the CETA; Article IV of the UK-Colombia BIT (2014).

<sup>70</sup> UNCTAD, *The Protection of National Security in IIAs* (n 13) 73,98.

<sup>71</sup> Article 22.2 (National Security) provides:

This Agreement is not to be construed:

- (a) to require either Party to furnish or allow access to information if that Party determines that the disclosure of the information would be contrary to its essential security interests;
- (b) to prevent either Party from taking actions that it considers necessary for the protection of its essential security interests: (i) relating to the traffic in arms, ammunition, and implements of war and to traffic and transactions in other goods, materials, services, and technology undertaken directly or indirectly for the purpose of supplying a military or other security establishment; (ii) taken in time of war or other emergency in international relations; or (iii) relating to the implementation of national policies or international agreements respecting the non-proliferation of nuclear weapons or other nuclear explosive devices; or
- (c) to prevent either Party from taking action in pursuance of its obligations under its international agreements for the maintenance of international peace and security.

<sup>72</sup> The COMESA Investment Agreement, Article 22 (1) (a) (in respect of protecting national security and public morals) and Article 22 (3) (in respect of protecting essential security interests).



it mainly to the arbitration tribunals to provide some further clarification of these terms'.<sup>73</sup> However, no arbitration interpretation to this effect has been identified. Some IIAs define 'essential security interests' with still further details. For example, the Canada-Peru BIT provides that:

4. Nothing in this Agreement shall be construed:

(b) to prevent any Party from taking any actions that it considers necessary for the protection of its essential security interests

(i) relating to the traffic in arms, ammunition and implements of war and to such traffic and transactions in other goods, materials, services and technology undertaken directly or indirectly for the purpose of supplying a military or other security establishment,

(ii) taken in time of war or other emergency in international relations, or

(iii) relating to the implementation of national policies or international agreements respecting the non-proliferation of nuclear weapons or other nuclear explosive devices<sup>74</sup>

The above provisions list cases relating to essential security interests. The details of such a list may vary slightly in different treaties, which sometimes refer to a WTO-like security exception.<sup>75</sup> Furthermore, a few IIAs expressly state that Article XXI of GATT 1994 and Article XIV *bis* of GATS are part of the agreement, such as the Australia-China FTA.<sup>76</sup>

<sup>73</sup> UNCTAD, *The Protection of National Security in IIAs* (n 13) 73.

<sup>74</sup> Article 10 (General Exception) of the Canada- Peru BIT (2006). Such a provision is typical in Canadian treaties, see e.g., Article 22.2 of the Canada-Korea FTA (2014); Article 10 (4) of the Canada-Peru BIT (2006); Article 10.4 of the Canada 2004 Model FIPA; etc.

<sup>75</sup> See e.g., Article 2102 (1) of the NAFTA. Also, Article 28.6 of the CETA provides:

Nothing in this Agreement shall be construed:

(a) to require a Party to furnish or allow access to information if that Party determines that the disclosure of this information would be contrary to its essential security interests; or

(b) to prevent a Party from taking an action that it considers necessary to protect its essential security interests:

(i) connected to the production of or traffic in arms, ammunition and implements of war and to such traffic and transactions in other goods and materials, services and technology undertaken, and to economic activities, carried out directly or indirectly for the purpose of supplying a military or other security establishment;

(ii) taken in time of war or other emergency in international relations; or

(iii) relating to fissionable and fusionable materials or the materials from which they are derived; or

(c) prevent a Party from taking any action in order to carry out its international obligations for the purpose of maintaining international peace and security.

<sup>76</sup> Article 16.3 of the Australia-China FTA (2015). Article XXI of GATT 1994 (Article XIV *bis* of GATS)

Such further clarifications about essential security interests seem to confine contacting states' actions to military-related purposes and emergency conditions. But, WTO practice shows that it is disputable whether such a clause does limit the essential security to the non-economic context, or whether the economic defence is a part of security in an emergency.<sup>77</sup> Given that states' actions against foreign SOE investments are sometimes taken for both economic and non-economic reasons, a problem may arise as to whether such actions fall within the scope of essential security interests. The key to this situation then is how broadly the tribunal is likely to interpret 'essential security interests'.

It is significant then that the 2015 Indian Model BIT provides an open-ended scope to essential security interests by entering the caveat 'including but not limited to', which explicitly incorporates 'action taken so as to protect critical public infrastructure'.<sup>78</sup> The provision accordingly seems explicitly to extend the exceptions

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provides:

1. Nothing in this Agreement shall be construed:

- (a) to require any Member to furnish any information, the disclosure of which it considers contrary to its essential security interests; or
- (b) to prevent any Member from taking any action which it considers necessary for the protection of its essential security interests:
  - (i) relating to the supply of services as carried out directly or indirectly for the purpose of provisioning a military establishment;
  - (ii) relating to fissionable and fusionable materials or the materials from which they are derived;
  - (iii) taken in time of war or other emergency in international relations; or
- (c) to prevent any Member from taking any action in pursuance of its obligations under the United Nations Charter for the maintenance of international peace and security. [emphasis added]

<sup>77</sup> For further discussions on WTO laws, see e.g., GATT Analytical Index, 'Article XXI: Security Exceptions' <[https://www.wto.org/english/res\\_e/booksp\\_e/gatt\\_ai\\_e/art21\\_e.pdf](https://www.wto.org/english/res_e/booksp_e/gatt_ai_e/art21_e.pdf)> accessed 5 Feb 2017.

<sup>78</sup> Article 17.1 of the 2015 Indian Model BIT provides:

Nothing in this Treaty shall be construed:

- (i) to require a Party to furnish any information, the disclosure of which it considers contrary to its essential security interests;
- (ii) to prevent a Party from taking any action which it considers necessary for the protection of its essential security interests including but not limited to:
  - (a) action relating to fissionable and fusionable materials or the materials from which they are derived;
  - (b) action taken in time of war or other emergency in domestic or international relations;
  - (c) action relating to the traffic in arms, ammunition and implements of war and to such traffic in other goods and materials as is carried on directly or indirectly for the purpose of supplying a military establishment;
  - (d) action taken so as to protect critical public infrastructure including communication, power and water infrastructures from deliberate attempts intended to disable or degrade such infrastructure; or
- (iii) to prevent a Party from taking any action in pursuance of its obligations under the United Nations Charter for the maintenance of international peace and security.

to both economic and non-economic considerations.

However, some treaties, like the China-Columbia BIT, do not enumerate the essential security interests, but require that the exception is ‘only applied where a genuine and sufficiently serious threat is posed to one of the fundamental interests of society’.<sup>79</sup> Hence, the pre-condition for host states to take restrictive measures would be that the foreign SOE investment poses a ‘genuine and sufficiently serious threat’ to fundamental interests. But, the security clause does not further explain what fundamental interests might encompass and what threats are likely to be seen as sufficiently serious.

Most IIAs do not provide further details of essential security interests, the US treaties being one example of this. In these cases, host states would retain considerable policy discretion to regulate SOE investments. The Letters of Submittal accompanying certain US BITs stated that:

...[A] Party’s essential security interests would include security-related actions taken *in time of war or national emergency*. Actions not arising from a state of war or national emergency must have *a clear and direct relationship to the essential security interests* of the Party involved.<sup>80</sup> (emphasis added)

However, recent US treaties omitted such a statement, leaving the scope of ‘essential security’ open to broad and open-ended interpretation. Furthermore, some treaties adopt a self-judging exception whereby a contracting state is allowed to take restrictive measures against foreign SOE investments insofar as ‘it considers necessary’ to protect the state’s essential security interests.<sup>81</sup> In this sense, host states seem to retain maximum policy discretion to regulate foreign SOE investments. Many recent treaty practices tend to accept a self-judging clause, for example the

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Similar provisions see Article 76 of the New Zealand- Singapore Closer Economic Partnership Agreement (CEP) (2000).

<sup>79</sup> Article 12 of the China-Columbia BIT.

<sup>80</sup> See e.g., Article XIV (1) of the Azerbaijan-US BIT (1997).

<sup>81</sup> The use of the term ‘necessary’ does not impair the self-judging nature of security exception under the self-judging exception clauses.

CETA, the Australia-China FTA, the China-Korea FTA, the Japan-Uruguay BIT, and so on.

Nevertheless, although security exception clauses allow host states to take action against foreign SOE investments, whether or not their restrictive measures are justifiable under treaties may be scrutinised by tribunals if an SOE investor files a case before an investment tribunal. The next part will therefore discuss the invocation of security exceptions by host states to justify actions against foreign SOEs and how tribunals will review this issue.

#### 5.4 Invocation of Security Exceptions to Justify Restrictive Measures Relating to SOE Investments

According to UNCTAD, at least 16 national security-related investment cases have been examined by international investment tribunals, and over one-third (277 cases) of all known investment arbitration cases concern investments in industries that may affect a country's national interests.<sup>82</sup> More importantly, national security arguments were used by the respondent states as a justification for measures against foreign investments taken in the post-establishment phase; that is, nationalisation or expropriations of investment by means of legislative acts, or cancellation of licenses or state contracts.<sup>83</sup> It is unsurprising if, in this context, a host state invokes national security reasons to justify its actions against foreign SOE investments.

However, while the security exception clauses discussed above may safeguard host states' ability to take action on grounds of national security, it is still uncertain whether restrictive measures against SOE investments would be found justifiable under the security exception clauses in investment arbitration since such a scenario has never been tested in investment arbitration. To date, only certain arbitral cases against Argentina have discussed the security exception clause. Apart from US investors, investors from other countries have also challenged Argentina's regulatory measures to tackle the economic crisis under different BITs, but only the US-

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<sup>82</sup> UNCTAD, *WIR 2016* (n 1) 97.

<sup>83</sup> *ibid.*

Argentina BIT included an ‘essential security interests’ exception which was invoked by Argentina to defend its actions.<sup>84</sup> However, even though US investors brought claims on the basis of nearly identical facts and the same security exception clause, tribunals reached a variety of conclusions about whether the essential security exception clause justified the disputed state measures.<sup>85</sup>

If an SOE investor claims that a host state’s restrictive measure constitutes a violation of investment treaty obligations, whether and to what extent the action is justifiable under the security exception clause will be determined by the tribunal on a case-by-case basis. The tribunal would then face the question of whether and to what extent it has the competence to review the state’s action and how to apply the security exception clause, but the approach and interpretations may vary under different exception clauses.

#### 5.4.1 Self-Judging Clauses: ‘Good Faith’ Test

When it applies the security exception clause, the tribunal is first faced with the problem of whether the security exception is self-judging or non-self-judging, because that will determine whether and to what extent the investment tribunal is competent to review the state’s restrictive measure in relation to SOE investments.

Some IIAs contain self-judging clauses that emulate Article XXI of the GATT. For example, Article 2102 (1) of NAFTA and Article 18 of the US 2012 Model BIT provide that nothing in the Agreement shall be construed to prevent any Party from taking any actions that ‘it considers’ necessary for the protection of its essential security interests. According to the Statement of Administrative Action in the US’ NAFTA Implementation Act of 1993, such a security exception is ‘self-judging’ in

<sup>84</sup> In early 2000, investors from the US, the UK, Italy and France brought claims against Argentina under their BITs with Argentina, but only the US-Argentina BIT presented a security exception clause. For further discussion see Prabhash Ranjan, ‘Protecting Security Interests in International Investment Law’ in Mary E Footer and others (eds), *Security and International Law* (Hart Publishing 2016) 295–6.

<sup>85</sup> Tribunals in the *CMS*, *Enron* and *Sempra* cases found the security exception clause inapplicable while the *LG&E* and *Casual Continental* tribunals reached the opposite conclusion, see William J. Moon, ‘Essential Security Interests in International Investment Agreements’ (2012) 15 *Journal of International Economic Law* 481, 485.

nature, although each government would expect the provisions to be applied by the others in good faith.<sup>86</sup> While the self-judging security exception clause clearly implies that the respondent state retains exclusive discretion to apply the clause, it is implicit that the invocation of the security exception by the state will be made in good faith.

Until now no arbitral tribunals have reversed a state's determination on what it considers necessary under a self-judging clause. But, some ICSID tribunals have expressed the view that the self-judging nature of such clauses does not entirely exempt contracting parties from international judicial reviews, i.e., contracting parties are subject to international responsibility under the Vienna Convention on the Law of Treaties.<sup>87</sup>

The *LG&E* tribunal, for example, stated that '[w]ere the Tribunal to conclude that the provision is self-judging, Argentina's determination would be subject to a good faith review anyway'.<sup>88</sup> In the *Enron* case, the tribunal found that judicial review of a non-self-judging clause is not limited to 'an examination of whether its invocation or the measures adopted were taken in good faith'.<sup>89</sup> Furthermore, in *Continental Casualty*, Argentina suggested that, even if Article XI is self-judging, 'a tribunal would be empowered to check the recourse to the exception was made in good faith'.<sup>90</sup>

Accordingly, international jurisprudence has underscored that self-judging clauses do not constitute a bar to the jurisdiction of tribunals.<sup>91</sup> Hence, if a tribunal faces a case

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<sup>86</sup> US Statement on Administrative Action of the NAFTA Implementation Act, 217

<<http://www.naftaclaims.com/commissionfiles/USStatementofAdministrativeAction.pdf>> accessed 12 September 2017; see also the Letter of Submittal of the Rwanda-US BIT (2008). For more discussion see Stephan W Schill and Robyn Briese, "If the State Considers": Self-Judging Clauses in International Dispute Settlement' (2009) 13 Max Planck Yearbook of United Nations Law 61, 111.

<sup>87</sup> Article 26 of the VCLT provides that '[e]very treaty in force is binding upon the parties to it and must be performed by them in good faith'. UNCTAD, *The Protection of National Security in IIAs* (n 13) 40.

<sup>88</sup> *LG&E Energy Corp., LG&E Capital Corp., and LG&E International, Inc. v. Argentine Republic*, ICSID Case No. ARB/02/1, Decision on Liability, 3 October 2006, para 214. See also *Enron Corporation and Ponderosa Assets, L.P. v. Argentine Republic*, ICSID Case No. ARB/01/3, Award (22 May 2007), para 327; *CMS Gas Transmission Company v. The Republic of Argentina*, ICSID Case No. ARB/01/8, Award, 12 May 2005, para 366.

<sup>89</sup> *Enron* (n 88), para 339.

<sup>90</sup> *Continental Casualty Company v. The Argentine Republic*, ICSID Case No. ARB/03/9, Award, 5 September 2008, 81 (footnote 271).

<sup>91</sup> Schill and Briese (n 86) 112–3.

involving an SOE investment under the self-judging clause, it will still have the power to review the state action for evidence of good faith.

The problem however is how to implement a good faith review. The *LG&E* tribunal considered that a good faith review should not significantly differ from the substantive analysis under a non-self-judging clause.<sup>92</sup> No further guidance was provided here, and the principle has never been tested by investment tribunals. In fact, the *LG&E* approach to good faith reviews could mitigate the difference between self-judging clauses and non-self-judging clauses, elevating the lower standard of a good faith review to that of a higher full-bodied substantive review and so deprive the explicit self-judging character of its merits.

Some tribunals also noted that ‘caution must be exercised in allowing a [state] party unilaterally to escape from its treaty obligations’ under a self-judging exception clause, which ‘would conflict in principle with the agreement of the parties to have disputes under the BIT settled compulsorily by arbitration’.<sup>93</sup> Here an important function of the good faith review is to preventing contracting states from misusing the self-judging security exception clause and ensuring a balance between state freedom of action and investor protection.<sup>94</sup> This is where a good faith review is of great importance to foreign SOE investments, especially when one considers that some restrictive measures targeting SOEs are criticised as protectionism. A good faith review may prevent host states from abusing self-judging security exceptions and thus help strike the proper balance between protecting foreign SOE investments and regulating SOE investments for national security reasons.

Yet whilst good faith has long been a core principle in international law, a workable standard of good faith review has yet to be fully developed.<sup>95</sup> The question, therefore, remains: what is meant by a good faith review and how can it be implemented in practice without conceding too much power to investment tribunals? The danger is that in reviewing the legality of state measures under self-judging exceptions

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<sup>92</sup> *LG&E* (n 88), para 214.

<sup>93</sup> *Continental Casualty* (n 90), para 187.

<sup>94</sup> Burke-White and von Staden (n 32) 378.

<sup>95</sup> *ibid.* See generally John F O’Connor, *Good Faith in International Law* (Dartmouth Publishing 1991).

investment tribunals may go as far as substituting the state's decision by their own view of what would be necessary for the protection of security and bring about the danger of making arbitrary interpretations.<sup>96</sup>

In *Djibouti v France*, Judge Keith in his Declaration considered that in invoking a self-judging clause a state should not act against the principles of good faith, abuse of rights and a misuse of power.<sup>97</sup> He further cited the ICJ's statement in the *Gabčíkovo-Nagymaros Project* case that the good faith obligation reflected in Article 26 of the Vienna Convention 'obliges the Parties [to a treaty] to apply it in a reasonable way and in such a manner that its purpose can be realized.'<sup>98</sup> Some scholars maintain this approach to concretising the good faith review because it addresses the characteristic element of self-judging clauses, namely the discretion accorded to states in favour of domestic over international interests.<sup>99</sup> Some scholars consider that the good faith review comprises two elements, including reasonableness - a rational basis for state action and honesty - of action and/or in the mind of the state.<sup>100</sup>

However, the above interpretation of good faith reviews is just a plausible approach rather than a clear guidance. In practice, it is disputable whether a line can actually be drawn between a good faith review and a substantive review. Furthermore, it is uncertain and unpredictable how an investment tribunal would review elements of good faith as either 'reasonableness' or 'honesty' should include both objective and subjective considerations.

My view on the self-judging exception clause is, firstly, a self-judging clause

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<sup>96</sup> Schill and Brieze (n 86) 120.

<sup>97</sup> As Judge Keith stated, 'those principles [of good faith, abuse of rights and détournement de pouvoir] require the State agency in question to exercise the power for the purposes for which it was conferred and without regard to improper purposes or irrelevant factors', *Certain Questions of Mutual Assistance in Criminal Matters (Djibouti v. France)* (Judgment) [2008] ICJ Rep 177, Declaration of Judge Keith, para 6 <<http://www.icj-cij.org/files/case-related/136/136-20080604-JUD-01-06-EN.pdf>> accessed 12 September 2017. See *ibid* 117–8, 124.

<sup>98</sup> *ibid*, cited *Gabčíkovo-Nagymaros Project (Hungary v. Slovakia)* (Judgement) [1997] ICJ Rep 7, para 142.

<sup>99</sup> Schill and Brieze (n 86) 125, 140.

<sup>100</sup> Burke-White and von Staden (n 32) 379; Shin Yi Peng, 'Cybersecurity Threats and the WTO National Security Exceptions' (2015) 18 *Journal of International Economic Law* 449, 467; Andrew D Mitchell, 'Good Faith in WTO Dispute Settlement' (2006) 7 *Melbourne Journal of International Law* 339, 345.



indicates a declaration of discretion that contracting states would determine any security exception. This would include whether or not a foreign SOE investment threatens its national security interests and what action against foreign SOE investment is necessary to protect national security. In this regard, tribunals are poorly placed to ‘second-guess’ the policy choice of a government.<sup>101</sup> Secondly, a self-judging clause does not bar a tribunal from reviewing state action subject to a good faith review. But, a good faith review should not impair a state’s discretion in taking action against SOE investments for the protection of national security interests. Thirdly, a good faith review under a self-judging clause is a review of whether or not the state invokes the self-judging exception in good faith, both subjectively and objectively, rather than a ‘substantive’ review of national security *per se*. In this sense, tribunals’ reviews are more like an oversight to prevent contracting states from abusing their discretion in self-judging or exercising the discretion improperly.

Accordingly, the good faith review would offer an important advantage in protecting SOE investments, namely, to prevent host states from abusing security exceptions against foreign SOEs for protectionism in disguise. Under the good faith test, tribunals could assess whether or not the state’s invocation of a self-judging exception served, subjectively, protectionist ends; and objectively, implemented improperly, *inter alia*, whether or not state exercised national policy was instituted in an obvious and deliberately arbitrary or otherwise unreasonable way. As a result, a policy which bars *all* Chinese SOEs from acquiring or otherwise gaining control of US companies because of the arguably high risk to US national security may covertly serve the aims of protectionism.<sup>102</sup> The sudden shut-down of SOE investment facilities such as a nuclear power station may similarly be considered an arbitrary action on the part of the State. Most importantly, in these cases the respondent state may bear a greater burden of proof in demonstrating that its

<sup>101</sup> Burke-White and von Staden (n 32) 381.

<sup>102</sup> In the 2016 Annual Report to the Congress, the US-China Economic and Security Review Commission said that Chinese SOEs could use technologies they acquired to benefit Chinese national interests ‘to the detriment of US national security’, and then recommended the Congress to bar Chinese SOE investments, see The US-China Economic and Security Review Commission, ‘2016 Report To Congress’ (2016) 121

<[https://www.uscc.gov/sites/default/files/annual\\_reports/2016 Annual Report to Congress.pdf](https://www.uscc.gov/sites/default/files/annual_reports/2016%20Annual%20Report%20to%20Congress.pdf)> accessed 12 September 2017.

invocation of self-judging clauses is in good faith.

Although it is uncertain whether the investment tribunal would be convinced in a particular case, the good faith test could constrain the freedom of states to invoke self-judging security exceptions, and then strike a balance between maintaining a host state's discretion in matters of national security and the protection of foreign SOEs from protectionism.

#### 5.4.2 Non-Self-Judging Clauses: A Substantive Analysis

Most investment treaties do not include the term 'it considers' in the security exception clause. Thus, a question arises as to whether a security exception clause without explicitly self-judging language, such as Article XI of the US - Argentina BIT, should be interpreted as inherently self-judging.

When foreign investors filed cases against Argentina in the aftermath of the crisis, the Argentinian government argued that Article XI of the US - Argentina BIT should be interpreted as self-judging, subject only to good faith review.<sup>103</sup> Article XI of the Treaty reads as follows:

[T]his Treaty shall not preclude the application by either Party of measures necessary for the maintenance of public order, the fulfillment of its obligations with respect to the maintenance or restoration of international peace or security, or the Protection of its own essential security interests.

However, claimant investors did not share the same understanding. In the *LG&E* case, for instance, the investor argued that viewing the clause as self-judging 'would result in the creation of a broad and sweeping exception to the obligations established under the Treaty and would eviscerate the very object and purpose of this kind of treaty'.<sup>104</sup> As a result, all the tribunals concluded that Article XI of the US-Argentina BIT is *not* self-judging, and that the tribunal should conduct a substantive

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<sup>103</sup> For example, *Enron* (n 88), para 324. See Burke-White and Staden (n 32) 393.

<sup>104</sup> *Sempra Energy International v. The Argentine Republic*, ICSID Case No. ARB/02/16, Award, 28 September 2007, para 372, cited Expert Opinion of Professor José E. Álvarez, 12 September 2005, para 64.

judicial review to examine whether or not the state action met with the conditions laid down by the treaty provisions.<sup>105</sup> In the instance of the *CMS* case, while the tribunal noted that the US government had a long-standing practice of self-judging character of security exception clause in BITs,<sup>106</sup> it concluded that, ‘when states intend to create for themselves a right to determine unilaterally the legitimacy of extraordinary measures importing non-compliance with obligations assumed in a treaty, they do so expressly’.<sup>107</sup>

Furthermore, tribunals referred to Article XXI of the GATT and the ICJ’s decisions in the *Nicaragua* and *Oil Platforms* cases, and held that ‘the language of a [security exception] provision has to be very precise in order to lead to a [positive] conclusion about its self-judging nature’.<sup>108</sup> Likewise, in the *LG&E* case, the tribunal held that the language of the BIT did not specify who should decide what constitutes essential security measures - whether it was Argentina itself or the tribunal. Based on the evidence from the understanding of the parties at the time the Treaty was signed in 1991, the tribunal concluded that the provision was not self-judging.<sup>109</sup>

Accordingly, if the tribunal finds that the security exception clause is *not* self-judging, the state’s action will then be subject to a *substantive* judicial review where the tribunal will determine whether the scope and the nature of the disputed measure are justified and indeed necessary.<sup>110</sup> But, some scholars argue:

...[T]he fact that a BIT is textually silent on the issue of deference does not, however, automatically translate into a presumption in favor of full review to

<sup>105</sup> See e.g., *Enron* (n 88), para 339; *CMS* (n 88), para 373. See also William J. Moon (n 85) 485; Burke-White and von Staden (n 32) 397.

<sup>106</sup> For example, Annex of the Nicaragua-US BIT provides that ‘the Parties confirm their mutual understanding that whether a measure is undertaken by a Party to protect its national security interests is self-judging’. The US-Russia BIT also includes a self-judging security exception clause, and the recent US 2012 Model BIT adopts the same approach.

<sup>107</sup> *CMS* (n 88), paras 368-70. See also *Sempra* (n 104), para 369.

<sup>108</sup> *Enron* (n 88), para 336; *CMS* (n 88), paras 371-2. Likewise, the ICJ held in the *Gabčíkovo-Nagymaros* case, referring to the conditions defined by the ILC, that ‘the State concerned is not the sole judge of whether those conditions have been met’, *Gabčíkovo-Nagymaros Project (Hungary v. Slovakia)* (Judgement) [1997] ICJ Rep 7, para 51.

<sup>109</sup> *LG&E* (n 88), para 212.

<sup>110</sup> See e.g., *CMS* (n 88), para 366; *Enron* (n 88), para 339; *LG&E* (n 88), para 214.

the extent that arbitrators may fully replace a state's assessment of a situation and the measures necessary to remedy it with their own. The permissible objectives of a BIT or language employed in defining the nexus requirement may indicate or even necessitate a lower standard of review that gives greater deference to a state's own invocation of an [exception] clause...<sup>111</sup>

Hence, they suggest that tribunals adopt the 'margin of appreciation' approach, famously employed by the European Court of Human Rights (ECHR), to reviewing state's action under a non-self-judging clause.<sup>112</sup> This interpretive approach, in essence, means that the Court will afford states a margin of appreciation as regards their compliance with the European Convention on Human Rights, and respect the state's determination of its obligations under the Convention.<sup>113</sup> Although the Court considers that 'it is for the national authorities to make the initial assessment of the reality of the *pressing social* need implied by the notion of necessity', the states' power of appreciation is not 'unlimited'. Furthermore, the Court is responsible for ensuring the domestic margin of appreciation goes 'hand in hand' with supervision that concerns 'both the aim of the measure challenged and its necessity'.<sup>114</sup> In the ECHR jurisprudence, the scope of margin can be narrower or wider in different kinds of cases, depending on what rights are at stake.<sup>115</sup> Meanwhile, the Court may assess the 'necessity' of the state action by using different formulations such as 'proportional', 'reasonable', 'justified' or 'a fair balance'.<sup>116</sup>

While the recourse of the margin of appreciation in international investment law is disputable in academia,<sup>117</sup> in the *Continental Casualty* case, the tribunal considered

<sup>111</sup> Burke-White and Staden (n 32) 371.

<sup>112</sup> *ibid*; Jürgen Kurtz, 'Adjudging the Exceptional At International Investment Law: Security, Public Order and Financial Crisis' (2010) 59 International and Comparative Law Quarterly 325, 365–6.

<sup>113</sup> Julian Arato, 'The Margin of Appreciation in International Investment Law' (2014) 54 Virginia Journal of International Law 545, 566–8; Yuval Shany, 'Toward a General Margin of Appreciation Doctrine in International Law?' (2006) 16 The European Journal of International Law 907, 910.

<sup>114</sup> Council of European, 'The Margin of Appreciation' <[https://www.coe.int/t/dghl/cooperation/lisbonnetwork/themis/echr/paper2\\_en.asp#P85\\_4072](https://www.coe.int/t/dghl/cooperation/lisbonnetwork/themis/echr/paper2_en.asp#P85_4072)> accessed 12 September 2017, cited *Handyside v. UK* [1976] ECHR 5, Judgement, paras 48–9.

<sup>115</sup> See 'Margin of Appreciation: An Overview of the Strasbourg Court's Margin of Appreciation Doctrine' *Open Society Justice Initiative* (April 2012) <<https://www.opensocietyfoundations.org/sites/default/files/echr-reform-margin-of-appreciation.pdf>> accessed 12 September 2017.

<sup>116</sup> Council of European (n 114).

<sup>117</sup> For further discussion see Julian Arato (n 113); Yuval Shany (n 113); William W Burke-White and Andreas von Staden, 'Private Litigation in a Public Law Sphere: The Standard of Review in Investor-State Arbitrations'

that ‘this objective assessment [whether the financial crisis in Argentina triggered the essential security exception in Article XI under the BIT] must contain a significant margin of appreciation for the State applying the particular measure: a time of grave crisis is not the time for nice judgments, particularly when examined by others with the disadvantage of hindsight’.<sup>118</sup> But, the tribunal then noted that although Article XI ‘involves naturally a margin of appreciation by a party invoking it, caution must be exercised in allowing a party unilaterally to escape from its treaty obligations in the absence of clear textual or contextual indications’.<sup>119</sup> As a result, the tribunal reached the same conclusion as other ICSID awards that Article XI is non-self-judging where ‘the tribunal has to evaluate whether the impugned measures were ‘necessary’ for the maintenance of public order and the protection of the essential security interests of Argentina within the meaning of the BIT’.<sup>120</sup>

Therefore, under a non-self-judging exception clause, even if a tribunal recognises that the host state enjoys a margin of appreciation to invoke the exception, it would still assess whether the state’s action qualifies under the clause as for the protection of national security or other national interests, and whether the action is necessary for the objective. Accordingly, if a host state invokes a security exception clause such as Article XI of the US-Argentina BIT in investment arbitration in order to justify its restrictive measures against foreign SOE investments, the tribunal is likely to employ a two-stage assessment: first, to decide what the essential security interests are, i.e., whether the SOE investment threatens essential security interests of the host state; and second, to determine what action is necessary, i.e., whether the restrictive measure is necessary for the protection of essential security interests.

In the litigation of dozens of BIT cases, Argentina learnt lessons that if the security exception clause was silent as to whether the invoking party could judge for itself when such measures were necessary, such as Argentina- US BIT, the tribunal would judge when the clause could be invoked. Therefore, the recent Argentina-Qatar BIT

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(2010) 35 Yale Journal of International Law 283.

<sup>118</sup> *Continental Casualty* (n 90), para 181. For further discussion on the ‘margin of appreciation’ in international investment law see Yuval Shany (n 113).

<sup>119</sup> *Continental Casualty* (n 90), para 187.

<sup>120</sup> *ibid*, paras 188-9.

provides a self-judging clause in this respect, stating that nothing shall be construed to preclude a state from applying measures that it considers necessary for the protection of its essential security interests, including measures adopted in time of war, armed conflict or ‘other types of emergencies’, or ‘in respect of international relations’.<sup>121</sup> While the meaning of ‘in respect of international relations’ is obscure, the ‘other types of emergencies’ clause could arguably stretch to economic crises that affect a state’s essential security.<sup>122</sup> Under these provisions, tribunals are nevertheless able to conduct a good faith test.

#### *A. SOE investment considered as a threat to essential security interests*

Under a non-self-judging clause, tribunals have to determine the scope and applicability of security exceptions. The first issue will be whether state’s action targets permissible objectives within the scope of the exception clause, i.e., the protection of essential security interests.

If the respondent state seeks to defend its restrictive measures against foreign SOE investments by citing security exceptions, the tribunal will firstly decide whether the SOE investment threatens any security interests of the state, and what the scope of the state’s security interests really is. Although this scenario has never been tested in a real case, so that a tribunal’s future interpretation retains unclear, some ICSID cases which have touched upon the notion of national security may have influenced future cases.

There was consensus amongst tribunals that the Argentina cases settled under Article XI of the Argentina-US BIT essential security interests cover economic emergency or crisis. For instance, the *CMS* tribunal stated that if the concept of essential security interests was understood and interpreted ‘to exclude other interests, for example, major economic emergencies’, it could well result in an ‘unbalanced understanding

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<sup>121</sup> Article 13 of the Argentina-Qatar BIT (2016).

<sup>122</sup> It should be observed, though, that the Qatar BIT differs from the US BIT in that the former does not mention ‘public order’ as one of the interests at issue. Luke Eric Peterson, ‘ANALYSIS: A look inside Argentina’s first new Bilateral Investment Treaty in 15 years’ *IARReporter* (13 December 2016) <<http://tinyurl.com/zx2govc>> accessed 12 September 2017.

of Article XI'.<sup>123</sup> Similarly, the *Enron* tribunal noted that:

[T]he object and purpose of the Treaty are, as a general proposition, to apply in the situation of economic difficulty and hardship that require the protection of the international guaranteed rights of its beneficiaries...any interpretation resulting in an escape route from the obligations defined cannot be easily reconciled with that object and purpose...<sup>124</sup>

The *Sempra* tribunal further considered that 'there is nothing that would prevent an interpretation allowing for the inclusion of economic emergency in the context of Article XI. Essential security interests can eventually encompass situations other than the traditional military threats for which the institution found its origins in customary law'.<sup>125</sup> In *LE&G*, the tribunal rejected the argument that 'Article XI is only applicable in the circumstances amounting to military action and war' and believed that 'when a State's economic foundation is under siege, the severity of the problem can equal that of any military invasion'.<sup>126</sup> Likewise, in the more recent *Continental Casualty* case, the tribunal pointed out that:

[I]t is well known that the concept of international security of States in the Post World War II international order was intended to cover not only political and military security but also the economic security of States and of their population... States have invoked necessity 'to protect a wide variety of interests, including safeguarding the environment, preserving the very existence of the State and its people in time of public emergency, or ensuring the safety of a civilian population'.<sup>127</sup>

Accordingly, it appears that international investment tribunals tend to adopt a broad interpretation of the scope of essential security interests which may *inter alia* encompass political, economic, social, environmental, and human rights interests.

My understanding of this broad interpretation is that the aim of the protection of a

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<sup>123</sup> *CMS* (n 88), para 360.

<sup>124</sup> *Enron* (n 88), para 331.

<sup>125</sup> *Sempra* (n 104), para 374.

<sup>126</sup> *LG&E* (n 88), para 238.

<sup>127</sup> *Continental Casualty* (n 90), para 175, cited Kenneth J Vandevelde, *United States Investment Treaties* (Kluwer Law and Taxation 1992) 222.

state's autonomy in matters of national security is the defence of sovereignty. In other words, competence to define what its essential security interests are should rest with the state itself. The concept of national security may lose both meaning and purpose if a third party has the power to decide whether a threat to a state's national security exists and what measures that state may take in response.<sup>128</sup> However, a broad interpretation by the tribunal could afford maximum protection of a state's national security. Therefore, although currently there are no cases involving national security concerns over SOE investments, should such disputes arise in the future it is conceivable that a tribunal would construe such concerns to fall within the scope of treaty security exceptions.

However, a broad interpretation of essential security interests may lead to an abuse of treaty exceptions since states may have various concerns over foreign investments, regardless of whether they are publicly or privately owned, arising from national security considerations. Although tribunals have so far tended to give a fairly broad interpretation of the notion of 'essential security interests', they have disagreed on the degree of severity of any security risk that would justify invoking the exception clause.

For example, in the *CMS* and *Enron* cases, the respective tribunals concluded that 'the Argentine crisis was severe but did not result in a total economic and social collapse',<sup>129</sup> and were not convinced by the argument that 'such a situation compromised the very existence of the state and its independence so as to qualify as involving an essential interest of the state'.<sup>130</sup> By contrast the *LG&E* tribunal considered that the crisis 'constituted the highest degree of public disorder' and threatened a 'total collapse' of Argentinian government, so that Argentina was excused under Article XI from liability for any breaches of the treaty.<sup>131</sup> In the *Continental Casualty* case, the tribunal held that a crisis that brought about a series of threats<sup>132</sup> qualified as a situation where 'the maintenance of public order and the

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<sup>128</sup> UNCTAD, *The Protection of National Security in IIAs* (n 13) 41.

<sup>129</sup> *CMS* (n 88), para 355.

<sup>130</sup> *Enron* (n 88), para 306.

<sup>131</sup> *LG&E* (n 88), paras 229, 231.

<sup>132</sup> *Continental Casualty* (n 90), para 180. Accordingly, the threats include:



protection of essential security interest of Argentina as a state and as a country was vitally at stake'.<sup>133</sup> These arbitral awards seem to suggest that only severe economic crisis can justify the invocation by the state of the essential security exception - although the tribunals did not agree on the requisite level of gravity of the economic crisis.

If a state invokes a non-self-judging clause to justify its actions against SOE investments on the grounds of national security, a tribunal may have to determine whether the threat posed by SOE investments is sufficiently severe to justify invoking treaty exceptions. The host state may argue that a foreign SOE investment distorted market competition posing a threat to economic security, so that measures like the imposition of taxes or the restricting of transactions to re-level the playing field all fall within security exceptions. In this scenario, even if the tribunal agreed that essential security interests cover economic security, it is uncertain whether the tribunal would accept that market distortion was severe enough to justify the invocation of security exceptions.

The state might have to bear the burden of proof to demonstrate severity. If a tribunal considers that security exception could only be applied when the whole economy of the state is at stake, it may be hard to convince the tribunal as market distortion or anti-competitive practice by one or more SOE investments in the host state would seem unlikely to initiate the collapse of an entire economy.

Notably in this context the *Continental Casualty* tribunal considered that the protection of essential security interests 'does not require that total collapse of the

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[T]he sudden and chaotic abandonment of the cardinal tenet of the country's economic life, such as the fixed convertibility rate which had been steadfastly recommended and supported for more than a decade by the IMF and the international community; the near-collapse of the domestic economy; the soaring inflation; the leap in unemployment; the social hardships bringing down more than half of the population below the poverty line; the immediate threats to the health of young children, the sick and the most vulnerable members of the population, the widespread unrest and disorders; the real risk of insurrection and extreme political disturbances, the abrupt resignations of successive Presidents and the collapse of the Government, together with a partial breakdown of the political institutions and an extended vacuum of power; the resort to emergency legislation granting extraordinary legislative powers to the executive branch...

<sup>133</sup> *ibid*, paras 180-1.

country or that a catastrophic situation has already occurred before responsible national authorities may have recourse to its protection'. Further, it considered that the invocation of the essential security exception clause 'does not require that the situation has already degenerated into one that calls for the suspension of constitutional guarantees and fundamental liberties'.<sup>134</sup>

If any future tribunal adopts this interpretation, it might be easier for states to justify their measures against SOE investment under security exceptions, because the tribunal would not require a threat to national security having occurred already. In other words, *any* (potential) risks posed by SOE investment might trigger the state to invoke security exception to justify actions in investment arbitration. Given that most (if not all) concerns about the adverse impact of foreign SOE investments on national security are merely suspicions, such an interpretation is likely to increase the invocation of security exception by states as long as there is a potential risk. Nevertheless, how any future tribunal will measure the severity of a threat to essential security interests remains to be seen.

*B. Whether a restrictive measure against SOE is a necessary action?*

If the tribunal agrees with the respondent state's argument that foreign SOE investment threatens essential security interests, in most cases,<sup>135</sup> it will then decide whether the state's restrictive measure was indeed a necessary response to the threat.

In arbitral practice, tribunals may adopt different tests in assessing the necessity. In the *Sempra* case, for example, the tribunal considered that its review should not 'substitute' the Government's choice; instead, the tribunal's duty 'only to determine whether the choice made was *the only one* available'.<sup>136</sup> In the *LG&E* case, the tribunal applied a reasonableness or rationality assessment, stating that:

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<sup>134</sup> *ibid*, para 175.

<sup>135</sup> As noted, most of security exception clauses have a nexus requirement and the typical language is 'necessary to'. For example, Article X (1) of the Bulgaria-US BIT (1992) provides that '[t]his Treaty shall not preclude the application by either Party of measures *necessary* for the maintenance of public order, the fulfilment of its obligations with respect to the maintenance or restoration of international peace or security, or the protection of its own essential security interests'.

<sup>136</sup> *Sempra* (n 104), para 351.

...Article XI refers to situations in which a State has no choice but to act. A State may have several responses at its disposal to maintain public order or protect its essential security interest. In this sense, it is recognised that Argentina's suspension of the calculation of tariffs in US dollars and the PPI adjustment of tariffs was *a legitimate way* of protecting its social and economic system.<sup>137</sup> (emphasis added)

The *Continental Casualty* tribunal held that the evaluation of necessity only required that 'Argentina had no other reasonable choices available, in order to protect its essential interests at the time, than to adopt these Measures'.<sup>138</sup> This tribunal therefore proposed that the necessity test required the measure in question be 'less restrictive'.<sup>139</sup> Some scholars suggest tribunals to take a 'proportionality review' when evaluating the necessity of state action, requiring the action to be rational, less restrictive, and balancing.<sup>140</sup>

Accordingly, if a state takes action against a foreign SOE investment, by for instance divesting the SOE investment, the tribunal may require the state to prove in a necessity test that no less restrictive measure is available to protect its national security, except for divesting the foreign SOE investment. Otherwise, the tribunal may need to assess whether the divestment of SOE investment is necessary to eliminate the threat to national security. Here it is apparent that the regulatory discretion of host states will be restricted by the necessity test under a non-self-judging clause, but it is unclear whether it can enhance legal clarity and predictability since the arbitral interpretation is not always consistent.

For SOE investments, the importance of the necessity test under a non-self-judging clause is to explicitly entitle the investment tribunal to judge whether state action is a necessary response. Some arbitral cases recognised that states, rather than tribunals, are in a better place to craft appropriate responses to emergency situations.<sup>141</sup> But under a non-self-judging clause, the necessity requirement is an objective criterion,

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<sup>137</sup> *LG&E* (n 88), para 239.

<sup>138</sup> *Continental Casualty* (n 90), para 199.

<sup>139</sup> *Kurtz* (n 112) 368.

<sup>140</sup> *ibid* 366.

<sup>141</sup> *Burke-White and von Staden* (n 32) 398.

subject to a reasonable, rational, proportional, or less restrictive test. Accordingly, although taking a restrictive measure against an SOE investment is usually a policy decision by the host state, such an action is likely subject to closer scrutiny by investment tribunals where the host state might be required to prove that no less severe measures was available to protect national security.

#### 5.4.3 Invoking the Necessity Defence under Customary International Law?

As mentioned earlier, most of the traditional IIAs do not provide a security exception clause. According to Article 25 of the ILC Articles on State Responsibility, however, states may invoke the necessity as a ground for derogating from their international obligations.<sup>142</sup> Hence, in the absence of any security exceptions in an IIA, it is nevertheless possible for a host state to invoke the necessity under customary international law to justify its action against a SOE investment.<sup>143</sup> In addition, even under a non-self-judging security exception clause, it is notable that host state might resort to both treaty provisions on national security exception and customary international law on state of necessity in order to justify its action against SOE investments in investment arbitrations.<sup>144</sup>

While a number of literatures have discussed the interplay between Article 25 and treaty exceptions,<sup>145</sup> for the purpose of this thesis, an important question still arises: to what extent can customary international law exempt a state from international responsibility if it takes restrictive measures against a SOE investment for national

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<sup>142</sup> Article 25 of ILC Articles on State Responsibility provides:

1. Necessity may not be invoked by the State as a ground for precluding the wrongfulness of an act not in conformity with an international obligation of that State unless the act: (a) is the only way for the State to safeguard an essential interest against a grave and imminent peril; (b) does not seriously impair an essential interest of the State or States towards which the obligation exists, or of the international community as a whole.

2. In any case, necessity may not be invoked by a State as a ground for precluding wrongfulness if: (a) the international obligation in question excludes the possibility of invoking necessity; or (b) the State has contributed to the situation of necessity.

<sup>143</sup> As noted, ILC Article on State Responsibility are generally accepted as a codification of existing customary international law, see UNCTAD, *The Protection of National Security in IIAs* (n 13) 34, 47.

<sup>144</sup> See, e.g., *CMS* (n 88), paras 117-8.

<sup>145</sup> For more discussion see Kurtz (n 112); August Reinisch, 'Necessity in Investment Arbitration' in IF Dekker and E Hey (eds), *Netherlands Yearbook of International Law Volume 41* (Springer 2010); Mitchell and Henckels, (n 35) 93.

security reasons? Will the tribunal's analysis of the defence under Article 25 be different if the dispute involves SOE investments?

In investment arbitrations, most tribunals read the requirement set out in Article 25 of ILC into Article XI of the BIT, thus conflating them into a single inseparable defence.<sup>146</sup> The *CMS* Annulment Committee, however, observed that Article XI and Article 25 are 'substantively different'. Article XI is a 'threshold requirement' that specifies the conditions under which the treaty obligations do not apply; whereas Article 25 is an excuse which is only relevant once it has been decided that there has otherwise been a breach of those substantive obligations.<sup>147</sup> Furthermore, the *CMS* Annulment Committee found that Article XI should be applied 'as *lex specialis* governing the matter and not Article 25', while Article 25 was a secondary rule which 'could only be subsidiary to the exclusion based on Article XI'.<sup>148</sup> In the *Continental Casualty* case, the tribunal concluded that:

[T]he invocation of Article XI under the BIT, as a specific provision limiting the general investment protection obligation (of a 'primary' nature) bilaterally agreed by the Contracting Parties, is not necessarily subject to the same conditions of application as the plea of necessity under general international law.<sup>149</sup>

Although it is uncertain whether future tribunals will follow the interpretation by the *CMS* annulment committee or the *Continental Casualty* tribunal, the arbitral practice to date indicates that the necessity defence under customary international law also provides flexibility for states to derogate from international obligations, and that the tribunal might consider the necessity in Article 25 of ILC in the interpretation of treaty exceptions on national security.<sup>150</sup>

<sup>146</sup> For example, the *Sempra* tribunal stated that 'the Treaty provision is inseparable from the customary law standard insofar as the definition of necessity and the conditions for its operation are concerned, given that it is under customary law that such elements have been defined', *Sempra* (n 104), para 376. See also *Enron* (n 88), para 334.

<sup>147</sup> *CMS* (n 88), Decision of the ad hoc Committee on the Application for Annulment of the Argentine Republic, 25 September 2007, para 129.

<sup>148</sup> *ibid*, paras 132-3.

<sup>149</sup> *Continental Casualty* (n 90), paras 162-7.

<sup>150</sup> *ibid*, para 168.

Hence, regardless of whether an IIA provides any security exception clause, customary international law can provide states certain legal flexibility in exceptional circumstances, including taking restrictive measures against foreign SOEs for national security reasons.

However, compared to national security exception in IIAs, the defence of necessity under customary international law only applied within narrow limits.<sup>151</sup> In fact, Article 25 of ILC requires a very high threshold of application, i.e., action taken must be ‘the only way for the State to safeguard an essential interest against a grave and imminent peril’, and it is essential that action ‘does not seriously impair an essential interest’ of another State.<sup>152</sup> Furthermore, the necessity defence would not be applicable if ‘the state has contributed to the situation of necessity’.<sup>153</sup> The Argentine cases demonstrate that it is very hard to argue that certain economic emergency measures are the ‘only way’ to counteract economic difficulties,<sup>154</sup> while the tribunals reached distinct conclusions on whether Argentina contributed to the crisis resulting in the state of necessity- although they assessed the issue on nearly identical facts.<sup>155</sup>

Despite of the divergence of interpretation, it would be very difficult for states to justify their action against SOE investments for national security reasons under the customary international law. In the KIO case, for example, it seemed hard for the tribunal to be convinced that a majority stake by KIO in BP would, as a grave and imminent peril, impair the essential interests of Britain, and that the divestment order was ‘the only way’ for the UK government. Furthermore, it is problematic whether the tribunal would conclude that the UK government’s action had precipitated the necessity, especially considering that KIO’s investment was a completely legal

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<sup>151</sup> UNCTAD, *The Protection of National Security in IIAs* (n 13) 34.

<sup>152</sup> Article 25 (1) of ILC Articles on State Responsibility.

<sup>153</sup> *ibid*, Article 25 (2) (b).

<sup>154</sup> According to the *CMS* decision, the necessity plea ‘is excluded if there are other (otherwise lawful) means available, even if they may be costlier or less convenient’, *CMS* (n 88), para 324. See also Reinisch (n 145) 153.

<sup>155</sup> For example, the *LG&E* tribunal concluded that ‘no serious evidence in the record that Argentina contributed to the crisis’, *LG&E* (n 88), para 257. But, the *CMS* tribunals found that ‘government policies and their shortcomings significantly contributed to the crisis and the emergency and while exogenous factors did fuel additional difficulties they do not exempt the Respondent from its responsibility in this matter’, *CMS* (n 88), para 329. Tribunals in *Sempra* and *Enron* reached the same conclusion with the *CMS* tribunal, see *ibid* 154.

transaction, following the UK government's call for privatisation of the company. Besides, one could doubt whether or not customary international law could provide justification for the protection of strategic industries unless it occurred in the context of a severe crisis resulting in social upheavals or affecting the human rights of the population.<sup>156</sup>

It is also notable that the invocation of essential security exception may exempt a state from obligations including compensation for a treaty breach, while the state is still subject to liability for compensation even if it has successfully invoked the necessity defence under customary international law.<sup>157</sup> Therefore, states that need to address national security concerns over SOE investments are strongly advised to include a self-judging security exception in investment treaties.

## 5.5 Concluding Remarks

In sum, exception clauses are of great importance both to SOE investments and host states in the context of international investment law. On the one hand, treaty exceptions limit the scope of investment protections for foreign SOEs and SOE investments. On the other, treaty exceptions explicitly preserve the freedom of host states to pursue policies or regulations in relation to foreign SOE investments.

In recent years, more and more treaties have tended to incorporate exception clauses to safeguard a state's regulatory space, and so it is increasingly likely for states to invoke such exceptions to justify their actions against foreign SOE investments in international arbitrations and to seek to justify their derogation from international investment treaty obligations. However, the scope and flexibility of regulatory freedom of a state may vary under different treaty exceptions. In this respect, whether, to what extent, and under what circumstances a state can take restrictive measures against foreign SOE investments without a breach of its international commitments very much depends on the specific language of the applicable

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<sup>156</sup> UNCTAD, *The Protection of National Security in IIAs* (n 13) 36.

<sup>157</sup> Sergey Ripinsky, 'Global Economic Crisis And The Danger Of Protectionism: Does International Law Help?' (2009) 1 (3) Amsterdam Law Forum 11.

investment treaty, including the exception clauses.

It is important to address that the situation might be different in pre-establishment and post-establishment scenarios. If a host state restricts the entry of a foreign SOE for national security considerations, the SOE investor might not be able to challenge the state action in the investment arbitration under most IIAs that merely provide protections for post-establishment phase. Returning to the Hinkley Point case, if the UK government had not approved the deal, the Chinese SOE investor cannot bring a case in ICSID anyway because the UK-China BIT does not have a commitment to pre-establishment non-discrimination treatment.<sup>158</sup>

However, if the dispute was brought under a pre-establishment treaty, such as the US 2012 Model BIT, it might be possible for a SOE investor to challenge the CFIUS review decision in an investment tribunal, unless the contracting states have explicitly made reservations or exceptions.<sup>159</sup> Since the security exception clause is in principle applicable to the entire treaty, including both pre-establishment and post-establishment commitments, it is possible for a state to invoke the security exception clause and justify its derogation from the pre-establishment commitment, such as a pre-establishment national treatment.<sup>160</sup> However, no case to date has tested whether an adverse CFIUS review decision could be subject to an investment arbitration,

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<sup>158</sup> The China-UK BIT only provides post-establishment protections in respect of non-discrimination treatment, fair and equitable treatment and expropriation, etc. For example, Article 2 provides:

(1) Each Contracting Party shall encourage and create favourable conditions for nationals or companies of the other Contracting Party for investment in its territory and, subject to its right to exercise powers conferred by its laws, shall admit such investment; (2) Investments of nationals or companies of either Contracting Party shall at all times be accorded fair and equitable treatment and shall enjoy the most constant protection and security in the territory of the other Contracting Party...

Article 3 (2) provides that, 'neither Contracting Party shall in its territory subject nationals or companies of the other Contracting Party as regards their management, use, enjoyment or disposal of their investments, to treatment less favourable than that which it accords to nationals or companies of any third State...'.<sup>159</sup>

Article 5 (1) provides:

[I]nvestments of nationals or companies of either Contracting Party shall not be expropriated, nationalised or subjected to measures having effect equivalent to expropriations or nationalisation (hereinafter referred to as 'expropriation') in the territory of the other Contracting Party except for a public purpose related to the internal needs of that Contracting Party and against reasonable compensation...

<sup>159</sup> For more discussion see Ch 3.

<sup>160</sup> As noted, one may argue that if the security exception clause under the US 2012 Model BIT is 'broad enough' for CFIUS and the President to review investment transactions considered necessary for the protection of its essential security interests, see Chow (n 22) 120.



leaving the issue unclear and unresolved.<sup>161</sup> Furthermore, the security exception clause does not automatically preclude the applicability of procedural provisions. Hence, investment tribunals are likely to scrutinise a host state's action against foreign SOEs in the pre-establishment phase, including an adverse decision in national security reviews. It is notable that the China-Canada BIT explicitly provides that the national security review shall not be subject to the dispute settlement provisions of the agreement.<sup>162</sup> But, most of the IIAs do not include such a reservation and thus the risk still exists.

Nevertheless, most investment treaties merely provide post-establishment obligations. If such a treaty contained a security exception clause, it would enable the host state to take regulatory measures against an established SOE investment and justify its derogation from international obligations such as non-discriminatory treatment. In the KIO case, for instance, if the Kuwait-UK BIT<sup>163</sup> adopted a similar exception clause as contained in the UK 2008 model BIT,<sup>164</sup> the UK government would have the ability to take safeguard measures, including a divestment order, against the established KIO investment for the protection of public interests,<sup>165</sup> without a violation of international obligations under the investment treaty. Accordingly, it seems of greater importance for host states that need to retain flexibility to regulate SOE investment to provide a security exception clause, so that the state would be allowed to take safeguard measures against SOE investments and justify the derogation from international obligations for the protection of national security or other important national interests.

While exception clauses permit host states to take action against SOE investments

<sup>161</sup> Gloudeman and Salidjanova (n 23) 25.

<sup>162</sup> Annex D 34 of the China-Canada BIT (2012).

<sup>163</sup> The UK government signed a BIT with Kuwait in 2009, but the Treaty is not in force and the text is not published.

<sup>164</sup> Article 7 (1) of the UK 2008 Model Agreement for the Promotion and Protection of Investments provides:

The provisions of this Agreement relative to the grant of treatment no less favourable than that accorded to the nationals or companies of either Contracting Party or of any third State shall not be construed so as to preclude the adoption or enforcement by a Contracting Party of measures which are necessary to protect national security, public security or public order...

Similar provisions see e.g., Article 7 (1) of the UK-Ethiopia BIT (2009, not in force); Article IV (1) of the UK-Columbia BIT (2010).

<sup>165</sup> Brown and Sheppard (n 17) 742.

for permissible objectives such as essential security interests, whether the action is justifiable under the investment treaty will be evaluated by tribunals. Arbitral practice is presently limited and inconsistent here. In the case of self-judging clauses, although the state retains considerable discretion on the scope and applicability of security exceptions, the tribunal still has the competence to review the action under the good faith test. But if the clause is non-self-judging, tribunals may exercise an even greater power to conduct a substantive review of the state actions against SOE investments. Here the interpretive approaches and conclusions are open to dispute and uncertainty.

Since the scenario in respect of SOE investments has never been tested, how any future tribunal will interpret the security exception clause and its justifications for a state's measures against SOE investments remains to be seen. In order to preserve a state's maximum policy discretion over considerations of national security arising from foreign SOE investments, it is suggested that such expressions as 'it considers' be used when drafting a security exception clause, so as to make it explicitly self-judging.

National security is a two-edged sword. On the one hand, it could be invoked by states to protect significant interests and critical infrastructure and to justify regulations against foreign investors without having to bear responsibility for a violation of treaty obligations. But, on the other hand, the abuse of national security concerns in market access may result in a discouraging and untrustworthy environment for foreign investments.<sup>166</sup> Furthermore, the misuse of national security considerations by taking restrictive measures after the investment establishes may create an unstable legal regime and insecure investment climate in the host state. After the delayed decision on the Hinkley nuclear project, for instance, the Chinese ambassador to Britain, Liu Xiaoming, said that the Hinkley Point project was a test of mutual trust between the UK and China, and that the openness of the market would be the condition for bilateral co-operation.<sup>167</sup> Blocking an investment by a particular Chinese SOE might discourage other Chinese SOEs and send a

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<sup>166</sup> UNCTAD, *WIR 2016* (n 1) 17.

<sup>167</sup> Liu Xiaoming, 'Hinkley Point is a test of mutual trust between UK and China' *Financial Times* (8 August 2016) <<https://www.ft.com/content/b8bc62dc-5d74-11e6-bb77-a121aa8abd95>> accessed 12 September 2016.

discouraging signal to all Chinese enterprises.

Indeed, national security and security-related concerns about foreign SOEs tend to reflect a mix of political and economic considerations. The real motives for taking measures on the grounds of national security against SOEs are often complicated and ambiguous. States face the dilemma that too open a market might result in a threat to national security, whilst over-restrictive security regulations might discourage foreign investors. In the end, it is necessary for states to strike the proper balance between protecting foreign SOE investors and investments and addressing legitimate national security concerns arising from SOE investments. The security exception clause should be invoked only as a last resort when other policies are not available to eliminate concerns over national security,<sup>168</sup> and the state should in principle provide an open environment to foreign investors and investments, regardless of their ownership structure.

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<sup>168</sup> UNCTAD, *The Protection of National Security in IIAs* (n 13) 22.



## CHAPTER 6:

### GENERAL CONCLUSIONS AND IMPLICATIONS FOR FUTURE INTERNATIONAL INVESTMENT LAW REGIME

This thesis has examined whether and to what extent evolving international investment treaties adequately respond to the rapid growth of SOE investments and, in particular, to what extent international investment treaties protect SOEs as investors and to what extent these protections take into account the twin objectives of the preservation of host states' interests and the promotion of foreign investments.

From the outset, Chapter 1 has shown that the international investment regime has been undergoing dramatic changes and has faced uncertainty in recent years where the rapid growth of SOE investments and the consequential regulatory responses taken by some states at both national and international levels have played a prominent role. Significantly, the rapid growth of SOEs as a relatively new type of investors has not only complicated the existing various tensions among host and home governments and investors, but has also intensified the divergence in investment law and policy regimes. After the main tension in international investment law has shifted from a 'North-South' divide to a 'Public- Private' debate, I argue that a third dimension of 'East-West' contest is now emerging. This fundamentally represents a contest between emerging economic powers from the East (or the 'state capitalism') and the traditional advanced economic powers from the West (or the 'market capitalism'). Consequently, the current IIA regime is facing three dimensions at play, where the 'Public-Private' conflict between foreign investors and host states remains the major tension and theme, while the 'North-South' divide and the 'East-West' contest between host and home states lead to additional complexity and divergence in the investment rule-making.

These new realities call for a systematic review of key provisions in IIAs to analyse whether and to what extent international investment law as it is evolving and changing is providing adequate response to all these changing circumstances. As such, the substantive chapters focus on the most important issues surrounding SOE investments to investigate the evolution of the IIA regime and discuss interactions

between SOEs and international investment law. As noted, the IIA regime was not created for protecting SOE investments. Hence, the primary challenging issue is whether SOEs qualify for international investment protections, with particular focus on whether or not SOEs can file claims against host states before arbitral tribunals. Chapter 2 has shown that while most IIAs are silent on the standing of SOEs, the definition clauses of ‘investor’ and ‘investment’ under most treaties are broad enough to include SOEs and SOE investments for international protections. Nonetheless, arbitral tribunals would have great discretion to determine whether an SOE acts as a (private) investor or exercises governmental functions as a state if the treaty does not explicitly include SOEs. Despite of the disagreement and debate in arbitral practice, tribunals are likely to rely on the ‘*Broches* test’ to determine whether an SOE is qualified as ‘a national of the contracting state’ under the ICSID Convention thus can bring a case against a host state. In such a case, I argue that the tribunal should focus on the specific instance of an SOE investment, rather than exclude an SOE from investment protections and ICSID jurisdiction merely due to state ownership, whereas it is possible to attribute SOE conduct to host states under both customary international law and investment arbitrations. Meanwhile, to prevent SOE investors from abusing investment arbitrations against host states, I argue that a refined definition of ‘investment’ would help limit the protective scope of investment treaties to genuine ‘investments’ that conform to the host state’s laws and legislation. Accordingly, policy makers are advised to review and refine the key terms in IIAs to clarify the scope of investment protections. Recently, an increasing number of IIAs have explicitly provided SOEs and even states as ‘investors’, and have included the ‘investment characteristics’ requirement in the definition of ‘investments’. Nevertheless, with the global expansion of SOEs and increased regulatory measures by host states, there will be more SOEs seeking for investment treaty protections through investor-state arbitrations. In this regard, host states may have to re-evaluate their IIA regimes and consider whether they are prepared to open up SOE regulations to arbitral scrutiny, and whether the investment treaties and associated mechanisms for dispute settlement need to be adjusted.

While foreign SOEs as an important source of FDI are welcomed in most cases, they have also given rise to a wide range of concerns in host states, such as national security and competitive neutrality concerns. To minimise the potential political

risks and negative effects of SOE investments, some countries have adopted various approaches to control or restrict the admission of foreign SOEs, especially including tightening mechanisms for FDI screening. As shown in Chapter 3, at the national level, SOE investors may face different conditions of admission from private investors and in different countries. Internationally, host states retain considerable discretion to admit foreign SOEs with a requirement of ‘in accordance with host states’ laws’ under most IIAs, including traditional IIAs concluded by European countries. By contrast, US treaties typically extend NT and MFN to the pre-establishment phase of foreign investments where the host state is prohibited from placing restrictions or different conditions on admission of foreign investments on the basis of nationality. Under such a ‘liberal’ investment regime, any restrictive measure by a host state concerning the admission of a foreign SOE may breach international obligations on the pre-establishment non-discrimination, except when this is done in accordance with relevant exceptions.

More importantly, Chapter 3 has argued that two divergent trends have emerged in recent years concerning admission: on the one hand, states tend to tighten the screening of foreign investments, including SOEs, at the national level; but on the other hand, many countries in their recent treaty practice have accepted obligations to provide pre-establishment treaty protections for foreign investors where SOEs will also be protected by such commitments. This disparity between national and international practice trends, in my opinion, exactly reflects the complexity and divergence in the new realities. In respect of liberalisation in the IIA regime, both Western countries and emerging economies seek to increase their firms’ access to contracting parties’ markets on the basis of non-discriminatory treatment and push host states to remove access barriers through investment arbitration. In particular, Western countries wish to obtain greater market access and more level playing field for their investors in emerging economies. In respect of the restrictive trend at national level, Western countries may not be willing to lose their firms’ competitive advantages in national and international markets when competing with SOE investors, whilst they become increasingly concerned to restrict foreign SOEs on grounds of national security or public policy reasons. While the two trends seem divergent *prima facie*, they both demonstrate the investment policies of states, which is essentially driven by the state’s political and economic interests. Nevertheless, it

remains to be seen whether the future investment policy and law regime will toward to more investment liberalisation or return to investment restriction and even protectionism.

Although investment treaties differ significantly in investment protections in the pre-establishment phase, almost all IIAs guarantee to accord foreign investments non-discriminatory treatment and fair and equitable treatment standard in the post-establishment phase. Accordingly, SOE investors and their investments are in principle entitled to NDT and FET standards of treatment in the territory of the host state, while the host state is subject to substantive obligations such that their regulatory measures against SOEs may breach protection commitments under international investment treaties. As shown in Chapter 4, old investment treaties merely focus on investment protections, whilst host states' regulatory rights are constrained by substantive obligations on treatment. However, recent investment treaties have struck a balance between protecting SOE investments and preserving regulatory space for host states to pursue national interests. Under the new generation IIAs, host states' concerns over SOEs such as competitive neutrality can be addressed through clarifying the 'in like circumstances' component of the NDT obligation, or invoking the 'public policy' exception. Nonetheless, arbitral practice has shown that tribunals have great discretion in deciding whether a host state's action against foreign SOEs violates any substantive protection obligation. Given the disagreement and uncertainty in arbitral practice, policy-makers need to further clarify substantive investment protection standards to preserve host states' national interests and to provide more guidance for tribunals in interpreting relevant rules. For instance, providing an express reference to ownership considerations in the definition of 'in like circumstances', explicitly including the 'competitive neutrality' objective in public policy exception provisions, and providing a circumscribed FET with specific components such as due process, denial of justice and manifest arbitrariness.

Substantive standards of treatment are of great importance for both investors and states. I argue that the evolution of relevant treaty practice demonstrates the struggle of states in striking a balance between affording protections to foreign investments and preserving regulatory space for pursuing legitimate public policies. In this regard,



protecting foreign investments, regardless of their ownership, should be the central component of substantive standards of treatment in order to prevent discriminatory and arbitral conducts by host states against foreign SOEs. However, some features of SOEs, such as the state ownership or competitive advantages obtained from their home governments, may generate tricky problems regarding the application scope of substantive standards of treatment. As noted in Chapter 4, in the case of NDT of SOEs, a question of comparisons may be raised when identifying ‘like circumstances’. Also, SOEs may be presumed to have weak legitimate expectations under FET, because they are used to higher levels of screening and slightly more stringent national regulations. Therefore, policy-makers may have to consider whether or not to adjust relevant substantive standards of treatment to SOEs. Furthermore, it is pressing for states to rethink and re-evaluate what protection guarantees they can afford to foreign SOEs, as current investment treaty obligations have the potential to conflict with regulatory measures against foreign SOEs. In the last decade, arbitrations against Western countries have prompted them to clarify and restrict core terms relating to investment protections, whilst the rise of foreign investment from emerging economies has changed their attitude and policies toward the IIA regime. As SOE investments will continue to increase in the foreseeable future, the reciprocity of investment protections will bear more divergence and policy debates between emerging economies and Western states.

In recent years, an increasing number of states tend to include exception clauses in IIAs to safeguard vital national interests, including national security interests. Accordingly, a host state may derogate from treaty obligations and justify their actions against SOE investments by invoking such exceptions. As shown in Chapter 5, whether, to what extent and under what circumstances a state can take restrictive measures against foreign SOEs without a breach of treaty obligations very much depend on the specific language of exception clause (e.g., whether is it self-judging or non-self-judging) and applicable scope of the treaty (e.g., whether it extends to the pre-establishment phase). Nonetheless, whether the state action is justifiable under investment treaties will be evaluated by arbitral tribunals. However, Chapter 5 has pointed out that although national security exception can be invoked by states to protect vital national interests, it may create a discouraging, distrustful and insecure climate for foreign investments in the host state. Hence, I argue that states should in

principle provide an open environment to foreign investors, regardless of ownership, while security exception clause should be invoked only as a last resort when other policies are not available to eliminate concerns over national security.

Taken together, the contribution of this thesis, by systematically reviewing and analysing the key issues relating to SOE protections under IIAs, represents a useful discussion and nuanced understanding of the adaptability of the evolving IIA regime to the changing realities in today's world. In this regard, this thesis offers two overarching findings.

The first is that while the old generation IIAs focus on investment protections, the new generational IIA do, on the whole, succeed in striking a balance of rights and obligations between investors and states. Therefore, on the one hand, SOE investors and investments are in principle qualified for investment protections, including enjoying substantive standards of treatment in host states and having the right to bring arbitration claims against states before international tribunals. As stated in Chapter 2 and 3, recent treaty practice tends to explicitly include SOEs as 'investors' and remove access barriers by extending non-discriminatory treatment to the pre-establishment stage. On the other hand, new generation IIAs allow host states to pursue national interests and public policy objectives in ways that might be inconsistent with investment treaty obligations by limiting the applicability of substantive treaty obligations and providing various exceptions. As stated in Chapter 4 and 5, host states may take restrictive measures against foreign SOEs and justify these conducts in arbitrations on grounds of national security or other legitimate public policies.

Secondly, the current investment regime is providing responses to the changing realities in foreign investment, but the policy and objectives are divergent in developing and developed countries. As Chapter 3 suggested, divergent trends on admission seem to emerge in developed and developing countries at both national and international levels. Chapter 4 has also shown that some developed countries have clarified and restricted core terms in substantive treaty obligations in order to preserve regulatory space and protect national interests, while emerging economies tend to embrace the IIA regime to expand protections for outward investments.

Essentially, the reason of such divergence is that the role of these countries in foreign investment is changing. As SOE investments from emerging economies expand, the future investment regime is likely to be subject to more divergence and policy debates. Both Western countries and emerging economies need to re-evaluate their roles and investment policies, and to rethink to what extent they can afford the reciprocity of IIA regime. In this regard, the task of updating old treaties is pressing and there is a call for further clarification and recalibration of substantive treaty obligations.

Today, it is common for states to be involved in international economic activities as ‘private’ actors. While some critics and regulators focus on state ownership of SOE investments for constructing the regulatory framework, I would argue that under the new reality with a rapid growth of SOEs, the central problem of the international investment regulation is not whether an investor on the basis of state ownership should be included or excluded from the treaty protection, but whether the host state has provided adequate protections for investors and are allowed to take regulatory measures for public policy objectives. Therefore, the proper and sensible IIA regime should not focus on the status of an investor, i.e., whether it is public or private. Instead, it should focus on specific behaviours of the investor, e.g., whether an SOE acts in a commercial capacity and whether the SOE investment is detrimental to national security and competition. In this respect, SOEs investing abroad can be considered as same as private investors. In any event, imposing different rules for investors or excluding SOEs from the investment regime merely on the basis of state ownership may not only undermine the primary purpose of investment protections, but also create discriminations against certain SOEs in the name of levelling the playing field between private and public investments.

It is notable that while SOE investments have attracted much attention in recent years, they only represent one facet of the evolution of international investment. Accordingly, the ‘Public-Private’ conflict remains the major issue of the international investment law regime, although the ‘East-West’ contest may create more divergence between Western countries and emerging economies. Currently, some Western countries are beginning to question the investment treaty programs designed by themselves. Meanwhile, a retreat from high level of investment

protections and a trend of investment protectionism has resurfaced. However, at the time of writing, it remains to be seen whether and to what extent the rapid growth of SOE investments – or the rise of ‘state capitalism’ – will further stimulate the evolution of the IIA regime, and whether states’ investment policies will move towards more liberal or restrictive. What is clear now is that regulatory responses to SOE investments are likely to be subject to closer arbitral scrutiny and extensive political debates.

Given the increased volume and significance of SOE investments from emerging economies, Western countries’ investment policies may increasingly be driven by political backlash against certain countries. Furthermore, the IIA regime may become to a product of political games among powerful states - especially considering the call for establishing a multinational framework for foreign investment. Nonetheless, in light of global effort towards a sustainable FDI, it is possible to develop towards a more balanced, non-discriminatory and liberal regime of international investment law that can best accommodate needs for investment protection, promotion and regulation in investors and (both home and host) states.

This thesis has demonstrated that both SOE investments and the evolution of international investment regime are complex and controversial topics with many issues worth in-depth studies in the future. While this thesis focuses on some of the important issues surrounding SOE investments in the context of international investment law, questions relating to SOE investors’ obligations such as corporate governance and disclosure, and the competitive neutrality of SOEs wait to be elaborated and discussed further in future research. As SOE investment continues to proliferate, it is beyond doubt that the relevant issues will be subject to extensive debates and examinations by scholars, arbitral tribunals and policymakers. It is hoped that this thesis contributes to the SOE commentary and provides some useful insights and recommendations for designing a more balanced, non-discriminatory and liberal international investment regime.

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